JUDGE PRESKA

05 CV 5636

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

OFFICE OF THE COMPTROLLER OF THE CURRENCY, 250 E Street, S.W. Washington, D.C. 20219 Plaintiff, v. ELIOT SPITZER, in his official capacity as Attorney General for the State of New York, Defendant. 120 Broadway New York City, New York 10271	)	Civil No. __________

MEMORANDUM OF PLAINTIFF OFFICE OF THE COMPTROLLER OF THE CURRENCY IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION

JUNE 2005

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The Office of the Comptroller of the Currency ("OCC"), the federal agency with plenary responsibility for supervision of the system of federally chartered banks, respectfully requests, pursuant to Fed. R. Civ. P. 65, that this Court enter a preliminary injunction restraining New York Attorney General Eliot Spitzer and all those acting in concert with him or at his direction (collectively, the "Attorney General" or "Defendant") from asserting visitorial authority over national banks and their operating subsidiaries pending the resolution of the merits of this action. The defining principle of the national banking system overseen by the OCC is its exclusively federal character. When Congress enacted the National Bank Act in 1864, mindful of potential state hostility to the new federal system, it used plain language to prohibit state authorities from "visiting" – asserting sovereign power over – national banks except as provided by federal law: "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 subdivision of Congress]." 12 U.S.C. § 484. Defendant flouts this federal law prohibition by asserting state authority to coerce disclosure of national bank information on pain of state enforcement proceedings.

The degree to which Defendant's assertions conflict with settled law is demonstrated by a recent series of district court decisions, all currently pending appellate review, that precluded state assertions of visitorial authority over national bank operating subsidiaries.[1/] In each case, it was

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[1/] In each case, states asserted visitorial licensing and enforcement authority over national bank operating subsidiaries, and in each case, the district court entered a declaratory judgment and injunctive relief in favor of the national bank operating subsidiaries. *Wachovia Bank N.A. v. Burke*, 319 F. Supp. 2d 275 (D. Conn. 2004), *appeal pending* 2nd Cir. No. 04-3770; *Wells Fargo Bank, N.A. v. Boutris*, 252 F.Supp. 2d 1065 (E.D. Cal. 2003) & *National City Bank of Indiana v. Boutris*, 2003 WL 21536818 (E.D. Cal. No. 03-655, July 2, 2003), *consolidated for appeal,* (9th Cir., Nos. 03-16194, 03-16197, 01-16461)*; Wachovia Bank v. Watters,* 334 F. Supp. 2d 957 (W.D. Mich. 2004); *appeal pending* 6th Cir. No. 04-2257; *National City Bank of Indiana v. Turnbaugh,* 367 F. Supp. 2d 805 (D. Md. 2005) *notice of appeal filed* June 3, 2005. The Second Circuit heard argument in the

taken as a given – often reflected in state statutory provisions – that no such visitorial authority could be exercised against parent national banks, at least extra-judicially. Indeed, Defendant was a signatory to *amicus* briefs that endorsed that principle: "It is true that Section 484 does not permit state officials to impose *administrative* enforcement measures (*e.g.*, cease-and-desist orders) against national banks." *Wachovia Bank, N.A. v. Burke*, No. 3:03 CV 0378, (D. Conn.), Brief of Amici Curiae, States and State Banking officials In Support of Defendant John P. Burke, Banking Commissioner at 15 (emphasis in original); "state officials may not examine or bring administrative enforcement actions against national banks * * * ." *Wachovia Bank v. Watters*, No. 04-2257 (6th Cir.), Brief of Amicus Curiae at 29. And yet, Defendant's extra-judicial coercive actions have been directed to national banks as well as to national bank operating subsidiaries and other lenders, without distinction. In so doing, Defendant not only ignores settled law but contradicts his previous recognition of that law.

These circumstances plainly satisfy the requirements for preliminary injunctive relief pending the resolution of the controversy on the merits. The OCC has a constant supervisory responsibility for the institutions threatened with visitation by Defendant, reflected in on-site examination teams and ongoing supervisory inquiries, communications, and direction. The Defendant's efforts to impose his own supervisory regime of inquiries, communications and direction undermines the OCC's supervisory role and is incompatible with the fundamental character of that federal system. Interference with the operation of the OCC's supervisory regime during the pendency of this lawsuit would constitute irreparable harm within the meaning of the applicable standards for preliminary relief. That interference also creates a justiciable case or

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appeal of the Connecticut decision on May 31, 2005.

controversy in that it constitutes actual harm to the OCC caused by Defendant and redressable by action of this Court. Federal statutes, regulations and caselaw support the likelihood that the OCC will prevail on the merits. Accordingly, the OCC's requested preliminary relief is fully warranted.

In a case presenting circumstances materially identical to those presented here, the United States Court for the District of Connecticut held that the OCC had shown that it would be irreparably harmed by ongoing state administrative proceedings, held that the state could not visit a national bank through administrative enforcement actions, and enjoined the state banking commissioner from maintaining those proceedings. *First Union National Bank v. Burke*, 48 F. Supp. 2d 132, 150, (D. Conn. 1999). The OCC's position on the merits is further supported by the Third Circuit's holding that only the OCC, and not the state of New Jersey, was authorized to enforce non-preempted New Jersey fair lending laws. *National State Bank v. Long*, 630 F. 2d 981 (3nd Cir. 1980).

Accordingly, federal law strongly supports the OCC's claims that it will be irreparably harmed in the absence of injunctive relief and that it is likely to prevail on the merits. On that basis, the OCC respectfully requests that this Court enter the requested declaratory and injunctive relief.

STATEMENT OF THE CASE

A. The OCC's Exclusive Supervisory and Regulatory Regime Over National Banks And Their Operating Subsidiaries.

The OCC is a bureau of the United States Treasury Department charged with the administration of the National Bank Act, 12 U.S.C. §§ 21 *et seq*., and oversight of the national

banking system. The OCC has comprehensive authority over the chartering, supervision, and regulation of virtually every aspect of the operation of banks organized under the National Bank Act. Under federal law, unless otherwise provided, state and federal laws apply to national bank operating subsidiaries to the same extent as they apply to its parent national bank.

In its capacity as administrator of the national banking system, the OCC conducts extensive examinations of the banking operations of national banks and their operating subsidiaries. These examinations evaluate the bank's compliance with principles of safe and sound banking and with applicable laws and rules concerning the bank's activities. 12 U.S.C. § 481. Federal law authorizes the OCC to inspect the bank's records and supervise its activities, including the records and activities of any operating subsidiaries. Congress also has provided the OCC an extensive array of regulatory tools with which to address unsafe or unsound banking practices or violations of law by national banks. *See, e.g.,* 12 U.S.C. §§ 93 (forfeiture of charter, civil money penalties); 1818 (cease and desist orders; restitution; removal of officers and directors; civil money penalties). Through its supervisory, regulatory and enforcement authority, the OCC oversees the activities of national banks and their subsidiaries and takes action to maintain the integrity and sound operation of the national banking system.

The OCC has exclusive "visitorial" authority over national banks and their operating subsidiaries except where federal law specifically provides otherwise. The term "visitorial" powers as used in 12 U.S.C. § 484 encompasses any examination, inspection of books and records, regulation or supervision of activities authorized or permitted pursuant to federal banking law, and enforcement of compliance with any applicable federal or state laws and with principles of safe and sound banking. 12 C.F.R. § 7.4000(a)(2). Under the OCC's regulations, an operating

subsidiary is subject to the OCC's exclusive visitorial authority to the same extent as a national bank. 12 C.F.R. § 5.34(e)(3); 12 C.F.R. §7.4006.

B. The OCC's Procedures for Supervising National Bank Fair Lending Compliance

The Home Mortgage Disclosure Act ("HMDA"), 12 U.S.C. §§ 2801-2810, requires lenders making loans secured by residential real property or home improvement loans to compile and make available to the public, in accordance with regulations issued by the Board of Governors of the Federal Reserve System ("FRB"), specified information about their mortgage lending activities. 12 U.S.C. § 2803. Lenders subject to HMDA must collect and include on a Loan Application Register ("LAR") numerous items of information, including the applicants' race, ethnicity, gender and income. They also must report information about the loan, including the location of the property to which it relates and, as of January 1, 2004, whether the loan is subject to the requirements of the Home Ownership and Equity Protection Act, 15 U.S.C. § 1639, and for loans that are originated, pricing information. The pricing information that is reported is the difference between the loan's Annual Percentage Rate ("APR") and the yield on Treasury securities having comparable periods of maturity if that difference is equal to or greater than 3 percentage points for first lien loans and equal to or greater than 5 percentage points for subordinate lien loans. Lenders must make the LAR available to the public in accordance with the timetable specified in the FRB regulations, after excluding the loan number and dates on which the application was filed and acted upon (information that could be used to identify individual loan applicants).

HMDA data are an important resource to the OCC in its responsibilities to monitor and enforce compliance with the Equal Credit Opportunity Act, Fair Housing Act, and state lending anti-discrimination laws. HMDA data alone cannot be a basis for a determination about the existence of unlawful discrimination in lending, whether based on evidence of disparate treatment or disparate impact. However, they are used in a number of ways as part of the OCC's fair lending compliance processes, including in assessing fair lending risks and compliance at individual banks.

In addition to information provided in HMDA LARs, the OCC uses information obtained through consumer complaints and other sources to identify banks that will receive comprehensive fair lending examinations. National banks are selected for fair lending examinations when the OCC identifies a higher risk of noncompliance with the fair lending laws, based on disparities identified in the HMDA data or other information about the bank, as well as on consumer complaints about the bank that indicate this risk. In addition, a random sample of national banks is selected each year to receive a comprehensive fair lending examination. Thus, OCC procedures ensure that national banks that exhibit evidence of potential discriminatory conduct, as well as a representative sample of national banks that do not exhibit indicia of fair lending compliance risk, receive fair lending examinations during the OCC examination cycle.

As an initial matter, HMDA LARs are reviewed for data integrity and accuracy. Banks are required to correct LARs that contain inaccurate data. OCC bank examiners and economists then review HMDA reports as part of our ongoing supervision of national banks and their operating subsidiaries to determine if there are any disparities in loan approvals and denials, and loan terms, by the borrower's race, ethnicity, income and gender, and in geographic markets.

OCC bank examiners and economists are experienced in conducting these reviews.

In the context of loan pricing, data will be reviewed to determine if there are disparities in the number or percentage of applicants receiving a loan for which a rate spread has been reported, as well as for differences in average rate spreads, according to borrower characteristics. Any such disparities are evaluated according to product type, loan purpose, property type, date of origination, and lien status.

If significant disparities are identified, as described above, OCC examiners and economists determine whether a loan file review will be conducted and whether a statistical model will be used to help determine if there is unlawful discrimination. File reviews are conducted using the OCC's comprehensive "Fair Lending Examination Procedures." As the federal regulator for national banks, there is no impediment to OCC review of loan files that contain nonpublic personal information under Title V of the Gramm-Leach Bliley Act, 15 U.S.C. §§ 6801-6809.

Whether a file review is conducted, a statistical model is used, or both, examiners determine the measures that will be used to conduct a comprehensive analysis of loan pricing, using measures including the all-inclusive Annual Percentage Rate, the note rate alone, overages, and/or fees. The bank's underwriting and pricing policies are reviewed as part of this examination scoping procedure.

For example, when an examination employs statistical procedures, a statistical model is developed to reflect the bank's underwriting and pricing process. This model uses statistical information about the bank's loans to test whether prohibited bases, such as a borrower's race or ethnicity, may have played a role in the loan pricing decision. It also can identify individual loan files that should be reviewed, by identifying borrowers who appear to have been treated less

favorably with respect to loan price than a white borrower with comparable creditworthiness factors (using the bank's underwriting policies and pricing factors).

Even when a fair lending compliance examination is conducted using statistical models, individual loan files are reviewed and additional information may be gathered and used to refine the statistical model, to determine whether a larger sampling is appropriate, and to identify other evidence of potential discrimination in addition to the statistical evidence. Statistical disparities that are unexplained by non-discriminatory reasons and are statistically significant at the 95% confidence level generally result in a finding of statistical evidence of disparate treatment discrimination.

In addition to use of statistical modeling and loan file reviews in connection with disparate treatment examinations, if the OCC determines that a neutral lending policy employed by a bank results in disproportionate adverse impact on members of a prohibited basis group, the OCC uses these procedures to determine whether the bank has engaged in unlawful discrimination due to this "disparate impact." Briefly, if a disparate impact is identified as resulting from an otherwise neutral lending policy or practice, the OCC seeks to determine whether the lending practice is justified by a legitimate business necessity. We further seek to determine whether an alternative policy or practice could achieve the same business purpose with less discriminatory effect.

If potential discriminatory practices are identified at any stage of the OCC's fair lending compliance review, bank management is directed to provide an explanation for the difference in treatment that was identified. Where practices expose the bank to unacceptable risk that a fair lending violation will occur, the OCC will direct bank management to modify its policies or practices to address that risk. If the OCC determines, at the conclusion of its fair lending

compliance review, that a bank has violated ECOA (or other fair lending law), it will order the bank to cease the discriminatory practices and will take other remedial action necessary to address harm to individual borrowers. In addition, a finding by the OCC that a bank has violated fair lending laws will be taken into account by the OCC in the bank's Community Reinvestment Act ("CRA") evaluation, and will adversely affect the bank's CRA rating.

C. NATIONAL BANK POWERS TO CONDUCT MORTGAGE LENDING DIRECTLY AND THROUGH OPERATING SUBSIDIARIES.

National banks chartered by the OCC are statutorily authorized to engage in the business of banking and all activities incidental thereto. 12 U.S.C. § 24(Seventh). In addition, some national bank powers, including the authority to make, arrange, and deal in loans secured by interests in real estate, are specifically authorized by statute. 12 U.S.C. § 371. Under OCC regulations, national banks may engage in bank-permissible activities by means of operating subsidiaries, subject to OCC licensure. 12 C.F.R. §§ 5.34; 34.1(b). Thus, federal law authorizes national banks to engage in a full range of real estate lending activities, both directly and through OCC-approved operating subsidiaries.

The "primary purpose" of 12 U.S.C. § 371, revised in 1974, was "to improve and update the mortgage investment tools of national banks to assist them in their efforts to respond to the demands of the real estate industry." H.R. Rep. No. 93-1114, 93rd Cong., 2d Sess. 44 (1974), *quoted in Conference of State Bank Supervisors v. Conover*, 710 F. 2d 878 (D.C. Cir. 1983). After amendment in 1982,[2] section 371 currently provides: "Any national banking association

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[2] Section 371, as revised in 1982, replaced a statutory scheme that imposed detailed restrictions on national bank real estate lending. As explained in the Committee Report: "The bill simplifies the real estate lending authority of national banks by deleting rigid statutory limitations. [The provision] is intended to provide national banks with the ability to engage in more creative and

may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests on real estate, subject to section 1828(o) of this title [3/] and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."

ARGUMENT

BECAUSE DEFENDANT'S ACTIONS IRREPARABLY HARM THE OCC'S VISITORIAL EXCLUSIVITY WITH RESPECT TO THE NATIONAL BANKING SYSTEM, AND BECAUSE THE OCC IS LIKELY TO SUCCEED ON THE MERITS, PRELIMINARY INJUNCTIVE RELIEF IS WARRANTED

STANDARD OF REVIEW

The OCC's interpretations of the National Bank Act to resolve ambiguities or fill gaps are entitled to judicial deference under *Chevron*. *Smiley v. Citibank (South Dakota), N.A.,* 517 U.S. 735, 739 (1996); *United States v. Mead Corp.*, 533 U.S. 218, 231 & n.13 (2001). The OCC's interpretations of its own regulations are "controlling" absent unusual circumstances. *Auer v. Robbins,* 519 U.S. 452, 461 (1997).

STANDARDS FOR INJUNCTIVE RELIEF

In the Second Circuit, preliminary injunctive relief is appropriate when a plaintiff establishes "(1) the likelihood of irreparable injury in the absence of such an injunction, and (2) either (a) likelihood of success on the merits or (b) sufficiently serious questions going to the merits to make them a fair ground for litigation plus a balance of hardships tipping decidedly in [Plaintiff's] favor." *Wisdom Import Sales Co., LLC v. LaBatt Brewing Company Ltd.*, 339 F.3d

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flexible financing, and to become stronger participants in the home financing market." S. Rep. 91-536, 97th Cong. 2d Sess. 27 (1982).

[3/] Section 1828(o), added in 1991, is the federal requirement for safety and soundness standards that apply to real estate lending. The standards for national banks and their operating subsidiaries are set forth in 12 C.F.R. Part 34, Subpart D, Appendix A.

101, 108 (2nd Cir. 2003); *see Jayaraj v. Scappini*, 66 F.3d 36, 38 (2d Cir.1995); *Covino v. Patrissi*, 967 F.2d 73, 77 (2d Cir.1992). The circumstances here clearly establish the likelihood of irreparable injury to the OCC. The overwhelming preponderance of legal authority establishes the likelihood that the OCC will succeed on the merits. Interim equitable relief is therefore clearly justified.

I. DEFENDANT'S ACTIONS SUBJECT THE OCC TO CONTINUING IRREPARABLE HARM BY INTERFERING WITH THE OCC'S EXCLUSIVE AUTHORITY OVER THE NATIONAL BANKING SYSTEM

The national banking system is predicated on the principle that it is to be governed by federal law and by a single supervisor, the OCC. *Cf. Central Nat'l Bank of Mattoon v. U.S. Dep't of Treas.*, 912 F.2d 897, 905 (7th Cir. 1990)(Posner, J.)("Those [national] banks are [the Comptroller's] wards, and his only wards; if they fail in droves, he will be blamed."). Federal law protects the supervisory relationship between banks and their federal supervisors against outside interference in a variety of ways. As the D.C. Circuit observed in explaining the common law privilege against disclosure of bank examination communications: "Because bank supervision is relatively informal and more or less continuous, so must be the flow of communication between the bank and the regulatory agency." *In re Subpoena Served Upon Comptroller of the Currency*, 967 F.2d 630, 634 (D.C. Cir. 1992). Any suggestion that state authorities may, at will, also exercise authority over that system compromises its integrity and the authority of the OCC. Declaration of Grace E. Dailey at ¶¶ 4-6. The OCC has no remedy at law for that continuing irreparable harm to the exercise of its supervisory responsibilities.

In the materially identical circumstances of the *First Union* case, Judge Arterton articulated the basis for her finding that the assertion of visitorial authority over a national bank

constituted irreparable harm:

> The potential imposition on national banks of enormous state penalties for violation of the Commissioner's cease and desist orders might negatively impact their operations and financial stability, and therefore effectively supplants the OCC's authority to oversee their financial integrity. In addition, proceeding with the state administrative enforcement process would presumably require proof of violations, which implicates the Commissioner's review of records of national bank operations, a visitorial power that federal law denies to states, except under narrow circumstances inapplicable in this case. Thus, the Commissioner's enforcement actions continue to displace the OCC's supervisory authority in a way that cannot be undone, since the exercise of such administrative authority is mutually inconsistent with the OCC's exclusive authority.

First Union, 48 F. Supp. 2d at 149-150 (footnotes omitted). Here, the Defendant's coercion of national banks under threat of administrative or judicial action poses precisely the same sort of interference with the OCC's supervisory powers. *See* Declaration of Grace E. Dailey at ¶¶ 2-6.

II. FEDERAL STATUTES, REGULATIONS, AND CASELAW DEMONSTRATE THAT THE OCC IS LIKELY TO SUCCEED ON THE MERITS

A. FEDERAL LAW PRECLUDES DEFENDANT'S ASSERTIONS OF VISITORIAL AUTHORITY OVER NATIONAL BANKS

The National Bank Act prescribes that, except where federal law otherwise provides, the OCC's visitorial authority over national bank operations is exclusive:

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

12 U.S.C. § 484 (emphasis added.). The OCC has promulgated regulations to implement the prohibition and the exceptions:

> Only the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks, except as provided in paragraph (b) of this section. State officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances

authorized by federal law. * * * .

12 C.F.R. § 7.4000(a)(1). The regulation explains that the exercise of visitorial powers over a national bank includes: (I) examination of the bank; (ii) inspection of the bank's books and records; (iii) regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) enforcing compliance with any applicable federal or state laws concerning banking-related activities. 12 C.F.R. § 7.4000(a)(2).[4/] *See also* OCC Advisory Letter 2002-9 (Nov. 25, 2002) ("AL 2002-9")(explaining effect of Section 484).

The sweeping effect of the OCC's visitorial exclusivity was confirmed by the Third Circuit in a case that held that the portions of a state fair lending statute that could be applied to national banks would be enforced by the OCC, and not by the state. *National State Bank v. Long*, 630 F. 2d 981 (3rd Cir. 1980). The Court determined that state reporting and disclosure requirements with respect to the geographical distribution of mortgage lending would be inconsistent with the terms of the federal HMDA and thus superseded. 630 F. 2d at 986. On the other hand, the Court identified no conflict between federal law and the state's prohibition on "redlining,"lending restrictions tied to specific geographical areas, and thus held that national banks could be required to comply with that prohibition. *Id*. at 986-88. But the Court determined that "when state law prohibits the practice of redlining, its enforcement so directly implicates concerns in the banking field that the appropriate federal regulatory agency has jurisdiction." *Id.* at 988. The Court

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[4/] The regulation also addresses some of the statutory exceptions to the OCC's exclusive visitorial authority. The regulation addresses: obtaining information about shareholders (12 U.S.C. § 62); ensuring compliance with state unclaimed property laws (12 U.S.C. § 484(b)); verifying payroll records for purposes of unemployment compensation (26 U.S.C. § 3305(c)); ascertaining the correctness of federal tax returns (26 U.S.C. § 7602); and enforcing the Fair Labor Standards Act (29 U.S.C. § 211). 12 C.F.R. § 7.4000(b)(1).

determined that the OCC's regulations providing for exclusive visitorial authority to be a reasonable interpretation of the National Bank Act 484, and to be "reasonable and practical." *Id.* at 988-989. "Thus, while the substantive law of New Jersey prohibiting redlining is not preempted, enforcement of the state statute is the responsibility of the Comptroller of the Currency rather than the State Commissioner." *Id.* at 989.

Congress subsequently endorsed the *Long* principle – that the OCC is responsible for enforcing applicable state law against national banks – by applying the concept in the specific context of interstate bank branching in the provisions of the Riegle-Neal Interstate Banking Act of 1994 ("Riegle-Neal"), Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994). Riegle-Neal singles out four specific types of state laws and provides that interstate branches of national banks are subject to such laws of a "host" state in which the bank has an interstate branch to the same extent as a branch of a state bank of that state, *except* when the application of such state laws to national banks is preempted. 12 U.S.C. § 36(f)(1)(A). But, even in those cases where state law is applicable to national banks, Riegle-Neal goes on to specify that authority to enforce the law is vested in the OCC: "The provisions of any State law to which a branch of a national bank is subject under this paragraph shall be enforced, with respect to such branch, by the Comptroller of the Currency." 12 U.S.C. § 36(f)(1)(B). "Fair lending" laws, the very type of law at issue here, is one of the four categories of laws for which Riegle-Neal specifies this result. In the *First Union* decision, the District Court of Connecticut relied upon *Long*, Riegle-Neal, and the long roots of visitorial exclusivity to determine that section 484 precluded the banking commissioner of Connecticut from bringing a cease-and-desist action against national banks. 48 F. Supp. 2d at 143-146. There, as here, the OCC filed suit for declaratory and injunctive relief to protect its

supervisory interests against state infringement. The District Court rejected the notion that *Long* was an "aberration," and determined that the OCC had shown a likelihood of success on the merits of its exclusive enforcement authority with respect to state administrative actions. 48 F. Supp. 2d at 150.[5]

This recent authority reflects recognition of the central role of visitorial exclusivity throughout the history of the national banking system. Section 484, which was part of the National Bank Act enacted in 1864, served an essential objective of Congress in protecting the newly formed system of national banks that would operate under distinct standards set by federal law, separate from the existing system of state banks. At the time the National Bank Act was being considered, both proponents and opponents of the creation of a national banking system expected that it would reduce state control over banking and might eventually replace the existing system of state banks.[6] Proponents of the National Bank Act were concerned that the states

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[5] The principle that states may not exercise visitorial authority over national banks is, of course, also supported by the recent operating subsidiary district court decisions addressed below. If states may not exert visitorial authority over operating subsidiaries, they *a fortiori* may not exert such authority over the parent national bank.

[6] Representative Samuel Hooper, who reported the bill to the House, stated in support of the legislation that one of its purposes was "to render the law so perfect that the State banks may be induced to organize under it, in preference to continuing under their State charters." Cong. Globe, 38th Cong. 1st Sess. 1256 (March 23, 1864). Opponents of the legislation believed that it was intended to "take from the States * * * all authority whatsoever over their own State banks, and to vest that authority * * * in Washington * * * ." Cong. Globe, 38th Cong., 1st Sess. 1267 (March 24, 1864) (statement of Rep. Brooks). *See also* statement of Rep. Pruyn (stating that the legislation would "be the greatest blow yet inflicted upon the States * * * .") Cong. Globe, 38th Cong., 1st Sess. 1271 (March 24, 1864); statement of Sen. Sumner ("Clearly, the [national] bank must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions.") Cong. Globe, 38th Cong., 1st Sess., at 1893 (April 27, 1864).

would attempt to undermine the national banking system through actions hostile to national banks, and took care to forestall that threat. The Supreme Court recently observed, with respect to one such precaution, the exclusive federal remedy for usury claims against national banks: "[T]his Court has * * * recognized the special nature of federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system that needed protection from 'possible unfriendly State legislation.'" *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003), *quoting Tiffany v. National Bank of Mo.*, 18 Wall 409, 412 (1874), (upholding removal jurisdiction over state law usury claims against national banks).[7/] The same concerns about hostile state interests animated the National Bank Act's reservation to the OCC of visitorial powers over national banks. Just as Congress acted to preclude the use of usury laws as a tool against national banks, it acted through Section 484 to forbid the more direct exercise of power by states through the assertion of visitorial authority. Instead, Congress established a separate federal regulatory regime to govern national banks and created the OCC to implement it. Section 484 establishes the OCC as the exclusive regulator of the banking operations of national banks, irrespective of the form that the regulatory action takes, and irrespective of whether the activities involve state or federal law, except where federal law specifically provides otherwise.

[7/] The federal law protections against state usury limits in the National Bank Act were prompted by a report from the Comptroller of the Currency that identified a need to protect national banks from variation in state-set usury rates. The Comptroller likened the potential hostile state use of usury statutes against national banks to Maryland's imposition of a tax upon the Second Bank of the United States, a state action that was declared violative of the Supremacy Clause in *McCulloch v. Maryland*, 17 U.S. 316 (1819). *See* 69 Fed. Reg. 1898 (January 13, 2004). Section 484 was thus enacted by a Congress that consciously designed protections for national banks in reliance upon the operation of the Supremacy Clause.

In using the term "visitorial," Congress chose a legal concept that has a history, one that vests exclusive supervisory authority in the visitor of an institution. The concept of visitation derives from Roman law and canon law, where it described the exclusive authority of the Church hierarchy over lesser Church institutions. *See* R. Pound, "Visitatorial Jurisdiction Over Corporations in Equity," 49 Harv. L.. Rev. 369, 369-70 (1935-36). Later, the concept was adopted to describe the authority of charitable founders over the operation of their charities, and the authority of the King over corporations that he had chartered. "[T]he visitatorial power was in the King, exercisable through his courts and ordinarily exercised by mandamus and by information in the nature of *quo warranto* in the King's Bench." *Id.* at 371; *see Guthrie v. Harkness*, 199 U.S. 148, 156 (1905); *First Union*, 48 F. Supp. 2d at 144. In every such application, the term has carried the connotation of exclusivity, contemplating only a single source of visitation for an institution. For a Congress concerned about state hostility to the newly created national banks, the use of the term "visitorial" with respect to the federal supervisor of the national banking system was plainly intended to exclude any other source of visitation.

In *Guthrie*, the Supreme Court explained the importance of the OCC's exclusive visitorial powers to furthering the objectives of Congress as follows:

> Congress had in mind, in passing [12 U.S.C. § 484] that in other sections of the law it had made full and complete provision for investigation by the Comptroller of the Currency and examiners appointed by him, and, authorizing the appointment of a receiver, to take possession of the business with a view to winding up the affairs of the bank. It was the intention that this statute should contain a full code of provisions upon the subject, and that no state law or enactment should undertake to exercise the right of visitation over a national corporation. Except in so far as such corporation was liable to control in the courts of justice, this act was to be the full measure of visitorial power.

Id. at 159. *See also Dietrich v. Greaney*, 309 U.S. 190, 194 (1940) ("The National Bank Act

constitutes 'by itself a complete system for the establishment and government of National Banks.'") *quoting Cook County Nat'l Bank v. United States*, 107 U.S. 445, 448 (1883)). The Supreme Court has consistently acknowledged that Congress intended to limit the authority of states over national banks precisely so that the nationwide system of banking created by the National Bank Act could flourish. For example, in *Easton v. Iowa*, 188 U.S. 220 (1903) the Supreme Court explained:

> [Federal legislation concerning national banks] has in view the erection of a system extending throughout the country, and independent, so far as the powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the states. * * * It thus appears that Congress has provided a symmetrical and complete scheme for the banks to be organized under the provisions of the statute. * * * [W]e are unable to perceive that Congress intended to leave the field open for the states to attempt to promote the welfare and stability of national banks by direct legislation. If they had such power it would have to be exercised and limited by their own discretion, and confusion would necessarily result from control possessed and exercised by two independent authorities.

Id. at 229, 231-232.

The scope of "visitorial" powers is expansive, including any act of the superintending official to inspect, regulate, or control the operations of a bank to enforce the bank's observance of the law. *First Nat'l Bank of Youngstown v. Hughes*, 6 F. 737, 740 (6th Cir. 1881), *appeal dismissed*, 106 U.S. 523 (1883); *see also Peoples Bank of Danville v. Williams*, 449 F. Supp. 254 (W.D. Va. 1978) (visitorial powers involve the exercise of the right of inspection, superintendence, direction, or regulation over a bank's affairs). In *Guthrie*, the Supreme Court confirmed the broad meaning of the term "visitorial" as used in Section 484, explaining that English common law used the term "visitation" to refer to the authority exercised by a superintending officer who visits a corporation to examine its manner of conducting business and

enforce observance of the laws and regulations. *Guthrie* 199 U.S. at 158 (*citing First Nat'l Bank of Youngstown v. Hughes*, 6 F. at 740). "Visitors" of corporations "have power to keep them within the legitimate sphere of their operations, and to correct all abuses of authority, and to nullify all irregular proceedings." *Id.* (citations omitted).

Based on express statutory text, OCC regulations, and judicial precedents it is clear that the Defendant has no authority to exercise any visitorial powers over the activities of national banks. The state statute at issue here falls into the category of "fair lending," and under the *Long* principle endorsed in a specific application by Riegle-Neal, it is the OCC, and not New York that has the authority to enforce the statute against national banks. As in *First Union*, the OCC has shown a likelihood of success on the merits that warrants preliminary injunctive relief.

B. THE EXCLUSIVITY OF THE OCC'S VISITORIAL AUTHORITY EXTENDS TO ACTIVITIES CONDUCTED BY NATIONAL BANKS THROUGH THEIR OPERATING SUBSIDIARIES

As noted above, a recent series of district court decisions, all currently pending appellate resolution, have sustained the OCC's position that national bank operating subsidiaries are subject to the same terms and conditions, including the applicability of state law, as their parent national banks. *Wachovia Bank v. Burke*, 319 F. Supp. 2d 275 (D. Conn. 2004), *appeal pending* 2nd Cir. No. 04-3770; *Wells Fargo Bank v. Boutris*, 252 F.Supp. 2d 1065 (E.D. Cal 2003) & *National City Bank of Indiana v. Boutris*, 2003 WL 21536818 (E.D. Cal. No. 03-655, July 2, 2003), *consolidated for appeal,* (9th Cir., Nos. 0-3-16194, 03-16197, 01-16461)*; Wachovia Bank v. Watters,* 334 F. Supp. 2d 957 (2004); *appeal pending* 6th Cir. No. 04-2257; *National City Bank v. Turnbaugh,* 367 F. Supp. 2d 805 (D. Md. 2005) *notice of appeal filed* 6/3/05. In each case, state officials were enjoined from taking visitorial actions against national bank operating

subsidiaries. We ask that this Court reach the same conclusions here.

For decades, national banks have used separately incorporated operating subsidiaries[8/] as a means of engaging in activities that the bank itself is authorized to conduct under the authority of 12 U.S.C. § 24(Seventh). The existence, function, and status of national bank operating subsidiaries was first formally recognized by the OCC in the mid-1960's, leading to the promulgation in 1966 of a regulation that codified the authority of national banks to engage in activities through operating subsidiaries. *See* 31 Fed. Reg. 11,459 (Aug. 31, 1966).

Since the official acknowledgment of operating subsidiaries in the 1960's, federal law has consistently recognized operating subsidiaries as a means through which parent banks conduct business. As a general principle of federal law, operating subsidiaries are treated as functionally identical to their parent banks except where federal law otherwise specifies. Operating subsidiaries are consolidated with—that is, their assets and liabilities are indistinguishable from—the parent bank for accounting purposes, regulatory reporting purposes, and for purposes of applying many federal statutory or regulatory limits.[9/] Courts have treated operating subsidiaries as equivalent to national banks in determining their powers and status under federal

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[8/] An "operating subsidiary" is defined to include entities in which a national bank has a controlling interest, but excludes subsidiaries that are specifically authorized by law, and subsidiaries acquired as satisfaction for a debt. 12 C.F.R. § 5.34(e)(2). Operating subsidiaries are distinct from subsidiaries expressly authorized for a specific purpose by federal law ("statutory subsidiaries") and from "financial subsidiaries," the creatures of 1999 legislation subject to an entirely separate regime. *See* 12 U.S.C. § 24a(g)(3) (A),(B).

[9] *See, e.g.,* 12 C.F.R. § 5.34(e)(4) (requiring application of, *e.g.,* statutory lending limit and limit on investment in bank premises to a national bank and its operating subsidiaries on a consolidated basis.)

law,[10] except where federal law requires otherwise.[11] The recognition of this operating subsidiary principle is not unique to national banks or to the OCC, but rather is a concept shared with other federal banking agencies, including the Federal Reserve Board and the Office of Thrift Supervision ("OTS").[12] In a 1968 interpretation, the Federal Reserve concluded that banks that are members of the Federal Reserve System may own operating subsidiaries: "[T]he incidental powers clause permits a bank to organize its operations in the manner that it believes best facilitates the performance thereof. One method of organization is through departments; another is through separate incorporation of particular operations. In other words, a wholly owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement." 12 C.F.R. § 250.141; *see also* 12 C.F.R. § 223.3(w)("operating subsidiary of a member bank is treated as part of the member bank"); 12 C.F.R. § 225(e)(2)(authorizing member banks to own operating subsidiaries without Board

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[10] *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.,* 513 U.S. 251 (1995) (sale of annuities by operating subsidiary); *Clarke v. Securities Industry Ass'n*, 479 U.S. 388 (1987) (securities brokerage operating subsidiary); *American Ins. Ass'n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988) (bond insurance subsidiary); *M & M Leasing Corp. v. Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978)(auto leasing subsidiary); *Valley Nat'l Bank v. Lavecchia*, 59 F. Supp. 2d 432 (D. N.J. 1999) (title insurance subsidiary); *Budnik v. Bank of America Mortgage,* 2003 U.S. Dist. LEXIS 22542 (N.D. IL 2003) (mortgage subsidiary).

[11] *See, e.g., Minnesota v. Fleet Mortgage Corp.*, 181 F. Supp. 2d 995 (D. Minn. 2001) (distinguishing banks and subsidiaries for purposes of the Federal Trade Commission Act under express terms of 15 U.S.C. § 41 note).

[12] An OTS regulation specifies that state law applies to thrift operating subsidiaries only to the extent it applies to the parent thrift. 12 C.F.R. § 559.3(n).

approval).[13/]

The current version of the OCC's rule authorizing operating subsidiaries provides that "[a] national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking as determined by the OCC, or otherwise under other statutory authority." 12 C.F.R. § 5.34(e)(1). The rule specifies the licensing process through which national banks seek OCC permission to conduct business by means of an operating subsidiary. 12 C.F.R. § 5.34(b).[14/] The rule makes clear that in conducting permissible activities on behalf of its parent bank, the operating subsidiary is acting "pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank." 12 C.F.R. § 5.34(e)(3).[15/]

Perhaps because the operating subsidiary principle has become so well-established at the

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[13/] The Second Circuit had occasion to resolve how the Bank Holding Company Act should be applied to the nonbank activities of **state** bank operating subsidiaries in *Citicorp v. Board of Governors of the Federal Reserve System*, 936 F.2d 66 (2nd Cir.1991)(Newman, J.), *cert. denied*, 502 U.S.1031 (1992). Noting that the Board disclaimed authority over activities conducted in the state bank, the Court held that it would be untenable to employ a "generation-skipping approach" that would treat the bank and its subsidiary differently. 936 F.2d at 74, 75.

[14/] The licensing procedures require a national bank to file an application with the OCC and receive OCC approval to acquire or establish the operating subsidiary. 12 C.F.R. § 5.34(e)(5)(i). An adequately or well capitalized national bank, as defined in OCC regulations, need not file a new notice, however, if the OCC has already permitted the bank to carry out the same activity in a prior operating subsidiary application. 12 C.F.R. § 5.34(e)(5)(vi). In addition, a well-capitalized and well-managed bank may obtain OCC approval to engage in certain activities specified by regulation by providing notice to the OCC within ten days of establishing or acquiring the operating subsidiary. 12 C.F.R. § 5.34(e)(5)(iv).

[15/] The meaning of the "terms and conditions" regulatory text for the application of state law is made express by the terms of 12 C.F.R. § 7.4006: "Unless otherwise provided by federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."

administrative level and in caselaw, Congress has only obliquely addressed operating subsidiary issues in legislation. Those instances, though, display a Congressional consciousness of the operating subsidiary principle.[16] Thus, for example, in distinguishing the category of "financial subsidiaries" it created in 1999, Congress characterized national bank **operating** subsidiaries as engaged "solely in activities that national banks are permitted to engage in directly and are conducted **subject to the same terms and conditions that govern the conduct of such activities by national banks**." Section 121 of the Gramm-Leach-Bliley Act, ("GLBA") Pub. L. 106-102, section 121, 113 Stat. 1338, 1373 (1999), *codified at* 12 U.S.C. 24a(g)(3)(A)(emphasis added). Conversely, when Congress desired a different outcome with respect to FTC authority over bank subsidiaries under the Federal Trade Commission Act ("FTC Act"), it specified that difference by stating that for that purpose a nonbank subsidiary "shall not be deemed to be a bank." 15 U.S.C. § 41 note (GLBA section 133(a)). Similarly, Congress in GLBA demonstrated that where it intends bank subsidiaries to be subject to regulation and oversight by other federal

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[16] The legislative history of the Gramm-Leach-Bliley Act, ("GLBA") specifically addresses the authority of national banks to conduct bank-permissible activities through operating subsidiaries:

> For at least 30 years, national banks have been authorized to invest in operating subsidiaries that are engaged only in activities that national banks may engage in directly. For example, national banks are authorized directly to make mortgage loans and engage in related mortgage banking activities. Many banks choose to conduct these activities through subsidiary corporations. Nothing in this legislation is intended to affect the authority of national banks to engage in bank permissible activities through subsidiary corporations, or to invest in joint ventures to engage in bank permissible activities with other banks or nonbank companies.

Report of the Senate Committee on Banking, Housing, and Urban Affairs, S. Rep. 106-44, at 6 (1999).

and state officials, it so provides expressly. *See* 12 U.S.C. § 1844(c)(4)(state visitation of bank subsidiaries engaged in securities and insurance activities). Where Congress has not so specified an outcome, as with visitation of national bank operating subsidiaries generally, it left resolution to the interpretation of the responsible administrative agency, the OCC.

The OCC has been delegated wide authority to implement the National Bank Act, both with respect to real estate lending[17/] and generally.[18/] As noted above, it has exercised that authority to provide that operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent bank, 12 C.F.R.§ 5.34(e)(3), including visitorial authority. 12 C.F.R. § 7.4006 ("Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."). Thus, federal law provides that, when established in accordance with OCC regulations and approved by the OCC, an operating subsidiary is a federally-authorized and federally-licensed means by which a national bank may conduct federally-authorized activities.

Federal district courts in California, Connecticut, Michigan and Maryland have upheld section 7.4006 against challenge and have determined that federal law prohibits state authorities such as Defendant from exercising visitorial power over the activities of an operating subsidiary. *Wells Fargo Bank v. Boutris*, 265 F. Supp 2d at 1169,1170; *National City Bank of Indiana v.*

[17/] "Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to [safety and soundness standards] and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order." 12 U.S.C. § 371.

[18/] "Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office, [subject to exceptions not here relevant]." 12 U.S.C. § 93a.

Boutris, 2003 WL 21536818 at *6-7; *Wachovia v. Burke*, 319 F. Supp. 2d at 280, 288; *Wachovia Bank v. Watters,* 334 F. Supp. 2d at 964-965; *National City Bank v. Turnbaugh,* 367 F. Supp. 2d at 818-819, 822.

The OCC, in light of this authority, is likely to prevail on the merits of the issues relating to visitation of operating subsidiaries.

C. SECTION 484'S "VESTED IN THE COURTS OF JUSTICE" EXCEPTION DOES NOT AUTHORIZE DEFENDANT'S ASSERTION OF VISITORIAL AUTHORITY.

Because Defendant here has used extra-judicial means to coerce compliance from national banks, he cannot make any claim that his actions fall outside the prohibition of section 484 under the "courts of justice" exception. It is foreseeable, however, that the issue will arise because Defendant has, in other cases, signed collective *amicus* briefs that make the argument that the exception in section 484 for visitorial powers "vested in the courts of justice" serves to immunize state visitorial actions that are prosecuted through the medium of state or federal courts instead of through state administrative processes.[19] The OCC has reached a contrary interpretation in the course of a rulemaking that is now set forth in an OCC regulation.[20] 69 Fed. Reg. 1895-1900. Because the OCC's regulation is supported by the statutory text, by the one Supreme Court case

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[19] *See, e.g.*, *Wachovia Bank v. Burke*, No. 3:03 CV 0378, (D. Conn.), Brief of Amici Curiae, States and State Banking officials In Support of Defendant John P. Burke, Banking Commissioner at 9-10.

[20] In promulgating this regulation, the OCC considered a *dictum* in the Connecticut district court's decision in *First Union* and the OCC's acquiescence in that position reflected in a pleading filed in that case. The meaning of the "courts of justice" exception was not contested in *First Union*, because the visitation involved administrative rather than judicial action. Subsequently, during the course of its rulemaking, the OCC comprehensively reevaluated and reconsidered its position and noted its disagreement with the *First Union dictum* in the preamble to the final rule. 69 Fed. Reg. 1897 n.17.

that addressed the text of the exception, and by the historical context of the adoption of section 484, the OCC's interpretation should prevail. The Defendant may not circumvent the prohibition of section 484 by the simple expedient of filing a lawsuit.

The OCC formally addressed the meaning of the exception in revised regulations implementing section 484:

> *Exception for courts of justice.* National banks are subject to such visitorial powers as are vested in the courts of justice. This exception pertains to the powers inherent in the judiciary and does not grant state or other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for national banks under Federal Law.

12 C.F.R. § 7.4000(b)(2); *see* 69 Fed. Reg. 1904 (January 13, 2004.) The OCC's interpretation begins with the text of the exception, which covers visitorial powers "vested in" the courts of justice. The text is not well adapted to the meaning that has been attributed to it by Defendant -- "*actions brought in* the courts of justice." The Supreme Court used just such a phrase when describing the way in which state authorities visit non-bank corporations: "The visitation of civil corporations is by the government itself, **through the medium of** the courts of justice." *Guthrie*, 199 U.S. at 157 (emphasis added). In contrast, the phrase visitorial powers "vested in" the courts speaks to the courts' inherent powers: *e.g.*, the powers to issue writs, to issue subpoenas, and to punish contempt. "Courts of justice are universally acknowledged **to be vested**, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates * * *." *Anderson v. Dunn*, 19 U.S. 204, 227 (1821)(emphasis added). The apparent legislative purpose for that exception was to preclude national banks from claiming immunity from judicial process – in itself a visitation – in civil suits that are not otherwise

visitations. Thus, in *Guthrie v. Harkness*, the Supreme Court determined, first, that the private suit by a bank shareholder was not a visitation precluded by the statute. 199 U.S. at 158. It then determined that the use of judicial process in a civil suit was precisely the sort of visitorial power addressed by the exception: "If the right to compel the inspection of books was a well-recognized common law remedy, as we have no doubt it was, even if included in visitorial powers as the terms are used in the statute, it would belong to that class 'vested in courts of justice' which are expressly excepted from the inhibition of the statute." 199 U.S. at 159.[21] Accordingly, the OCC's interpretation is supported by the sole Supreme Court case ever to address the text of the provision.

Historical context also defeats the suggestion that section 484 protects only against state visitations conducted by administrative process, and not judicial process. In 1864, coercive administrative procedures of the sort that are now common were rare to nonexistent. As *Guthrie* noted, visitations would instead commonly be effected through judicial lawsuit. 199 U.S. at 197. Under the mid-19th century New York law governing state-chartered banks, the banking commissioner was required to seek an injunction for suspension of the bank's operation if the bank violated its charter. H. Bodenhorn, "State Banking in Early America, A New Economic History" 167 (2002). Defendant's position would attribute to Congress, in a world where state visitations were effected primarily through the courts of justice, the intent to create a prohibitory rule followed by an exception that swallowed the rule. The implausibility of such an interpretation

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[21] The OCC's textual interpretation is further supported by the neighboring exception for visitations by Congress or its constituent subdivisions. The limited forms of national bank visitation that could be exercised by Congress would be the issuance of subpoenas or citation for contempt. Thus the paired exceptions speak to the use of inherent institutional powers by the courts and Congress respectively.

defeats Defendant's argument and supports the OCC's contrary reading.

CONCLUSION

For the foregoing reasons, because the Defendants actions are causing the OCC irreparable harm and because the OCC is likely to succeed on the merits, the OCC respectfully requests that the Court grant the OCC's motion for preliminary injunctive relief.

Respectfully submitted,

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