NO. 04-3770-CV

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

WACHOVIA BANK, N.A., and
WACHOVIA MORTGAGE CORPORATION,

Plaintiffs-Appellees,

v.

JOHN P. BURKE,
in his official capacity as Banking Commissioner
of the State of Connecticut,

Defendant-Appellant

On appeal from the
United States District Court for the District of Connecticut

BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF APPELLANT BURKE AND IN SUPPORT OF REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and 29(c), NASAA hereby represents that it has no parent corporation and that there is no publicly held corporation that owns 10% or more of NASAA's stock.

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IDENTITY, INTEREST, AND AUTHORITY OF AMICUS CURIAE

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 66 members, including the securities regulators in all 50 states, the District of Columbia, and Puerto Rico. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.[1]

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state law. Their fundamental mission is protecting consumers who purchase securities or investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries – many of them bank affiliates – who offer and sell securities to the public.[2] State securities regulators license firms and their agents, investigate violations of state law, file

[1] Pursuant to Fed. R. App. 29(a), NASAA states that all parties to this appeal have consented to the filing of this brief.

[2] In keeping with the modern regulatory approach known as functional regulation, state securities regulators assert their jurisdiction based principally upon the nature of the financial activity involved, not the nature of the entity engaged in that activity. Accordingly, with certain exceptions, bank entities offering securities to the public are subject to state securities regulation, along with more traditional broker-dealers and their registered representatives. *See, e.g.*, 12 U.S.C. § 24a (national banks may affiliate with financial subsidiaries); 15 U.S.C. § 6701(f) (jurisdiction of state securities regulators is preserved).

enforcement actions when appropriate, and educate the public about investment fraud. They also advocate for the adoption of strong, fair, and uniform securities laws and regulations at both the state and federal level. All of these activities parallel and complement the work of the Securities and Exchange Commission ("SEC"), which regulates the securities markets under federal law. This state/federal partnership maximizes investor protection, while at the same time allowing the securities industry to thrive.

NASAA supports the work of its members in all of their endeavors. For example, the association offers training programs on compliance examination techniques, coordinates multi-state enforcement actions, publishes investor education materials, and presents the views of its members in testimony before Congress. Another core function of the association is to represent the membership's position, as *amicus curiae*, in significant legal proceedings that may have a widespread impact upon investors and securities regulators.

This appeal raises issues of serious concern to NASAA and its members. The lower court has upheld the validity of rule 7.4006, 12 C.F.R. § 7.4006, promulgated by the Office of the Comptroller of the Currency ("OCC") in 2001. That rule, in a single sentence, substantially amended the National Bank Act ("Act") and insulated hundreds of state-chartered operating subsidiaries of national banks across the country from state visitorial powers. First and most immediately, the lower court's decision removes an important layer of consumer protection provided to the public by the Connecticut Banking Commissioner and other state banking regulators. Second, the decision endows the OCC with a legally indefensible power to rewrite, not merely interpret, the federal statute that the agency administers.

Allowing an administrative agency to wield such power is always objectionable. The OCC has repeatedly demonstrated a resolve to amass exclusive regulatory jurisdiction over banks and their affiliates to a degree never intended by Congress. As stated by U.S. Senator Paul Sarbanes, Ranking Member of the Senate Banking, Housing, and Urban Affairs Committee, in April:

> In recent years, the OCC has embarked on an aggressive campaign to declare that state laws and enforcement efforts are preempted if they have any impact on a national bank's activities. The OCC has zealously pushed its preemption agenda into areas where the States have exercised enforcement and regulatory authority without controversy for years.

See Review of the National Bank Preemption Rules: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 108th Cong., 2d Sess. (Apr. 7, 2004) (opening statement of Sen. Paul S. Sarbanes) (hereinafter "Sarbanes Statement").[3]

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[3] *Available at:* http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=106

This exclusionary regulatory philosophy has drawn fire from diverse groups, ranging from lawmakers to law enforcement officials, because it harms the public. As the worlds of banking, insurance, and securities increasingly intersect, NASAA and its members are concerned that the OCC may seek to encroach further upon state regulatory jurisdiction, not only in banking, but potentially in the areas of insurance and securities as well. As an organization dedicated to investor protection and attuned to the critical role of state regulation with respect to all types of financial services, NASAA is equipped to address the implications of the lower court's ruling and to assist this Court in reaching a correct result.

STATEMENT OF ISSUES

Whether federal law preempts state regulation of operating subsidiaries of national banks, where (1) the administrative regulation underlying the preemption claim is invalid; (2) the state banking law at issue does not otherwise conflict with federal law; and (3) the preemption of state regulation will needlessly expose the public to a heightened risk of abuse at the hands of unscrupulous lenders, without furthering the policies that underlie federal banking law.

ARGUMENT

I. Federal Law Does Not And Should Not Preempt State Regulation Of Operating Subsidiaries Of National Banks

The Supreme Court has recognized three types of preemption: *express preemption*, where Congress has explicitly defined the extent to which its enactments preempt state law; *field preemption*, where state law is preempted because it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively; and *conflict preemption*, where state law is pre-empted to the extent that it actually conflicts with federal law. The Supreme Court has found conflict preemption where it is impossible for a private party to comply with both state and federal requirements, or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *English v. Gen. Elec. Co.*, 496 U.S. 72, 78-79 (1990) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)) (other citations omitted).

None of the three established forms of preemption apply in this case. Federal law simply does not preempt state regulation of operating subsidiaries of national banks. Congress has never expressly preempted state regulation of national banks or their operating subsidiaries, nor has it occupied the field of such regulation. On the contrary, Congress and the Courts have repeatedly declared that states have a significant role to play in regulating national banks and their affiliates. For example, in *Atherton v. FDIC*, 519 U.S. 213, 222 (1997), the Supreme Court held that state standards of fiduciary duty apply to federal savings and loan associations, and stated that "[I]n 1870 and thereafter, this Court held that federally chartered banks are subject to state law." When Congress passed the Riegle-Neal Act in 1994, permitting national banks to operate interstate branches, it cautioned that the states' important role in regulating banks was not to be displaced:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities. Congress does not intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities.

H.R. Rep. No. 103-651, at 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074.

The only type of preemption at issue here is "conflict" preemption, arising from OCC rule 7.4006, 12 C.F.R. § 7.4006. *See Wachovia Bank, N.A. v. Burke*, 319 F. Supp. 2d 275, 280, 281 (D. Conn. 2004) (identifying rule 7.4006 as the "crux" of the controversy and the primary source of conflict at issue). Rule 7.4006 provides that state law shall apply to operating subsidiaries of national banks to the same extent that it applies to national banks. This backhanded provision confers upon operating subsidiaries the same immunity from state visitorial powers that national banks enjoy under Section 484 of the Act, 12 U.S.C. § 484. A conflict thus arises between the OCC rule and Connecticut's visitorial authority under the Banking Law of Connecticut, Conn. Gen. Stat. §§ 36a-1 *et seq.*

Rule 7.4006 is, however, invalid. The rule constitutes an impermissible attempt by a regulatory agency to expand the scope of a federal statute in derogation of Congressional intent, as measured by traditional canons of statutory construction. In the absence of rule 7.4006, Connecticut's law passes muster under the standard for conflict preemption established by the Supreme Court, because the law does not "prevent or significantly interfere" with the exercise of a national bank's powers. *See Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996).

The OCC's preemptive rule should be stricken on policy grounds as well. Connecticut's law, and similar state banking laws, protect consumers against abusive lending practices. The OCC rule removes those protections, at least as to operating subsidiaries of national banks, and it does so needlessly because state law poses no threat to the policies underlying federal banking regulation. Striking down rule 7.4006 is important not only to restore state regulation of the lenders at issue, but also to confine the OCC's preemption efforts and to help ensure that the OCC does not encroach upon the states' authority to regulate other financial services industries, including insurance and securities.

For these reasons, rule 7.4006 is invalid and Connecticut's exercise of regulatory authority over state chartered operating subsidiaries of national banks engaged in mortgage lending is proper. The district court's holding to the contrary should be reversed.

A. Regulation 7.4006 Is Invalid Because It Conflicts With Congressional Intent

Rule 7.4006 should be set aside. A court must invalidate an administrative regulation if, measured by traditional canons of statutory construction, the regulation conflicts with Congressional intent: "The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *See Chevron, U.S.A, Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 n.9 (1984).

Rule 7.4006 fails the *Chevron* test. The plain language of Section 484 of the Act limits the exercise of visitorial powers only with respect to "national banks," not with respect to operating subsidiaries of national banks. *See* 12 U.S.C. § 484(a). While operating subsidiaries of national banks may not have existed in 1864 when Congress passed the Act, *see Wachovia v. Burke,* 319 F. Supp. 2d at 283, they have been part of the banking landscape for the past 40 years, by OCC's own account. *See* Final Visitorial Powers Rule, 69 Fed. Reg. 1895, 1900-01 n. 47 (Jan. 13, 2004). Moreover, until 2001, they operated without the immunity from state visitorial powers set forth in OCC regulation 7.4006. *See* Final Rule on Investment Securities, Bank Activities, and Operations, 66 Fed. Reg. 34789 (July 2, 2001) (12 C.F.R. § 7.4006 became effective Aug. 1, 2001). Since 1933, Congress has amended the Act repeatedly to deal expressly with "affiliates" of national banks, which are defined to encompass subsidiaries. *See, e.g.*, 12 U.S.C. § 221a (defining "affiliate"); 12 U.S.C. § 52 (requiring separation of stock of national bank and its affiliates); 12 U.S.C. §§ 161(c), 481 (establishing reporting and examination requirements as to affiliates). However, Congress chose not to bring operating subsidiaries within the ambit of Section 484's limitation upon visitorial powers. *See* 12 U.S.C. § 484.

This difference in legislative treatment reflects genuine distinctions between state chartered operating subsidiaries of national banks and their corporate parents. This is true from both a legal and a business perspective. Legally, the Act establishes a clear-cut definition for national banks that operating subsidiaries simply do not meet. *See* 12 U.S.C. §§ 21-27; 221, 221a(a) (establishing the requirements for national bank status, including a certificate of authority from OCC and eligibility for membership in the Federal Reserve System). Case law supports this distinction. In *Minnesota v. Fleet Mortgage Corp.*, 181 F. Supp. 2d 995 (D. Minn. 2001), the district court held that Minnesota could enforce the FTC telemarketing sales rule against a mortgage lending subsidiary of a national bank because the operating subsidiary was not a "bank" under the plain statutory language. The relevant provision of the Federal Deposit Insurance Act defined "bank" to mean "any national bank, State bank, District Bank, and any federal branch and insured branch." *Id.* at 1000. The court stated that "[t]here is no ambiguity in this definition. The definition of 'bank' identified by Congress simply does not include subsidiaries of banks." *Id.*

National banks and their operating subsidiaries are also distinct from a business standpoint: banks derive a commercial benefit from establishing subsidiaries for mortgage lending purposes. They do so to limit exposure to claims arising from the subsidiary's line of business. *See* Brief for Amicus Curiae American Bankers Association et al. at 14, Joint App. at 74. This commercial reality belies the Appellees' suggestion that operating subsidiaries are merely de facto divisions or departments of their parent banks. Even where entities can be viewed as "functional equivalents," the Supreme Court has rejected the notion that this equivalence justifies a disregard for the plain language of a federal banking law. *See Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361, 373-74 (1986) (rejecting Federal Reserve Board attempt to expand definition of "bank" to include their "functional equivalents" under Bank Holding Company Act).

An additional indicator of Congressional intent under *Chevron* is the historical context in which Congress has acted or refrained from acting. *See Food & Drug Administration v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) (FDA's attempt to bring tobacco products within its regulatory jurisdiction conflicted with Congressional intent under *Chevron*). Here, the subject of dispute is a distinct class of lenders that are state-chartered corporations. Such corporations have unquestionably been the subject of state regulation virtually throughout our country's history. *See, e.g., CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 85-91 (1987). Against this backdrop of traditional state authority, the lack of any reference to operating subsidiaries in Section 484 can properly be viewed as evidence of Congress's determination that these entities should remain subject to state regulation.

Congressional intent has also been forcefully expressed in the unusually intense public controversy that OCC's preemptive regulations have sparked, and in the Congressional response to that controversy. Rule 7.4006, adopted in 2001, is just one in a series of regulations promulgated by the OCC that severely restrict the authority of states to regulate the activities of national banks and their subsidiaries. In January of this year, the OCC issued two final rule amendments further curtailing the states' visitorial powers and enlarging the scope of federal preemption beyond Congressional and judicially recognized boundaries. *See* Final Visitorial Powers Rule, 69 Fed. Reg. 1895 (Jan. 13, 2004); Final Preemption Rule, 69 Fed. Reg. 1904 (Jan. 13, 2004).

When the OCC proposed these rules, they attracted a deluge of criticism from a broad spectrum of interested parties, including state banking regulators, attorneys general, governors, public interest groups, and most significantly, members of

Congress. *See, e.g.*, Sarbanes Statement, *supra*, at 2 (reviewing the "unanimous and strong outcry" from state organizations and consumer groups in response to the OCC's preemptive rules); Letter from the National Association of Attorneys General to the Office of the Comptroller of the Currency, at 1 (Oct. 6, 2003) ("the OCC has embarked on an aggressive campaign to declare that state laws and enforcement efforts are preempted if they have any impact on a national bank's activities");[4] Letter from The Conference of State Banking Supervisors to The Honorable John D. Hawke, Jr., Office of the Comptroller of the Currency, at 5 (Sept. 26, 2003) ("The proposed rule would radically rewrite the time honored standard for federal preemption as interpreted by the courts and intended by Congress.").[5]

All of these groups share the view that the OCC's preemptive regulations unnecessarily expose consumers to a heightened risk of fraud and abuse by limiting the authority of state regulators to apply state laws to national banks, in a manner that Congress did not intend. *See id.* Particularly telling are the letters submitted to the OCC by groups of Senators and Congressmen. For example, ten members of the Senate Committee on Banking, Housing, and Urban Affairs wrote:

> Congress has previously voiced its intent that national banks not be immune from coverage by state laws . . . . The OCC now appears to be

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[4] *Available at* http://www.naag.org/issues/20031006-multi-occ.php.

[5] *Available at:* http://www.csbs.org/government/regulatory/comment_ltrs/cl_09.29.03.pdf.

> ignoring both the Supreme Court and Congress by pursuing a preemption agenda that would override any state law that has any impact on a national bank.

Letter from Ten Senators to The Honorable John D. Hawke, Jr., Comptroller of the Currency, at 2 (Nov. 24, 2003);[6] s*ee also* Letter from Sixteen Members of the House Committee on Financial Services to The Honorable John D. Hawke, Jr., at 1 (Apr. 3, 2003) (declaring that OCC's threatened preemption of the Georgia Fair Lending Act as applied to national banks and their operating subsidiaries would "violate a clear Congressional directive that States be permitted to augment federal law with more meaningful consumer protections").[7]

In direct response to the OCC's regulations, both the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee held oversight hearings to review the OCC's controversial approach to preemption. *See Congressional Review of OCC Preemption: Hearing Before the House Financial Services Committee Oversight and Investigations Subcommittee,*

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[6] *Available at:* http://banking.senate.gov/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=158&Month=11&Year=2003.

[7] *Available at:* http://www.csbs.org/government/legislative/federal_preemption/Barney Frank Ltr to OCC for Predatory Mortgage Lending.pdf

108th Cong., 2d Sess. (Jan. 21, 2004);[8] *Oversight of the Office of the Comptroller of the Currency: Hearings Before the Financial Services Committee,* 108th Cong., 2d Sess. (Apr. 1, 2004);[9] *The Review of the National Bank Preemption Rules: Hearings Before the Senate Banking, Housing, and Urban Affairs Committee,* 108th Cong., 2d Sess. (Apr. 7, 2004).[10] Subsequently, the House Financial Services Committee approved an amendment highlighting the negative effects of the OCC's preemption rule on consumer protection and questioning the OCC's ability to fill the regulatory void resulting from state preemption. *See Amendment offered by The Honorable Luis Gutierrez to the Views and Estimates of the Committee on Financial Services on Matters to Be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005* (passed Feb. 25, 2004) ("The Committee notes further that this expansion of authority comes without congressional authority") (hereinafter "Gutierrez Amendment").[11]

This flurry of Congressional activity culminated earlier this month, when "The Preservation of Federalism in Banking Act" was introduced in both the

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[8] *Available at:* http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=273&comm=4House

[9] *Available at:* http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=290

[10] *Available at:* http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=10

[11] *Available at:* http://financialservices.house.gov/media/pdf/022504bvam2.pdf.

House and Senate to scale back the OCC's preemption regulations. *See* H.R. 5251, 108th Cong., 2d Sess. (Oct. 7, 2004); S. 2973, 108th Cong., 2d Sess. (Oct. 9, 2004).[12] The statement of Senator Corzine introducing the Senate version, S. 2973, aptly summarizes the intent of the bill:

> This legislation responds to a sweeping new rule issued by the Office of the Comptroller of the Currency, the agency that regulates national banks. The OCC's new rule gives the agency unprecedented authority to pre-empt State laws, thereby shielding national banks and their non-bank and State-chartered affiliates from many important consumer protections. . . . [I]t is important that we immediately intervene to reverse the OCC's regulatory overreach and prevent the agency from preempting all state consumer protection laws and state authority to enforce related laws.

See 150 Cong. Rec. S10988 (daily ed. Oct. 9, 2004).[13]

Of particular relevance to this case, both the House and Senate bills would in effect repeal rule 7.4006. They each provide that "No provision of this title [which includes Section 484 of the Act] shall be construed as preempting the applicability of State law to any State-chartered nondepository institution subsidiary of a national bank." *See* S. 2973, 108th Cong., 2d Sess. § 4 (2004); H.R. 5251, 108th Cong., 2d Sess. § 4 (2004). Although not yet enacted into law and therefore not

[12] The House bill has 25 co-sponsors, including senior representatives, lending additional weight to the bill as evidence of Congressional intent.
[13] *Available at:* http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=2004_record&page=S10989&position=all.

dispositive, these bills provide further evidence that the OCC's preemptive regulations, including 7.4006, conflict with Congressional intent.[14]

While these recently introduced bills were not available to the lower court at the time of its decision on June 1, 2004, the court nevertheless had before it ample evidence of Congress's intent for purposes of the *Chevron* analysis – the plain language and structure of the Act, the historical tradition of corporate regulation by the states, and the Congressional concerns leading up to the proposed corrective legislation. That evidence shows unmistakably that the restraints on visitorial powers set forth in Section 484 apply only to national banks and that state chartered operating subsidiaries remain subject to state regulation. The district court's holding to the contrary was erroneous and should be reversed.[15]

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[14] The pendency of these bills should not dissuade the Court from acting immediately to reverse the district court and invalidate rule 7.4006, an unlawful regulation. *See Bob Jones University v. United States*, 461 U.S. 574, 599 (1983) ("It is, of course, not unknown for independent agencies . . . to misconstrue the intent of a statute; Congress can and often does correct such misconceptions, *if the courts have not done so*.") (italics added).

[15] In three recently reported cases, other federal district courts have upheld rule 7.4006. *See Wachovia Bank, N.A. v. Watters,* No. 5:03-CV-105, 2004 WL 1948655 (W.D. Mich. Aug. 30, 2004); *National City Bank of Indiana v. Boutris,* No. Civ. S-03-0655 GEG J., 2003 WL 21536818 (E.D. Calif. July 2, 2003); *Wells Fargo Bank, N.A. v. Boutris,* 265 F. Supp. 2d 1162 (E.D. Calif. 2003); *see also WFS Financial, Inc. v. Dean,* 79 F. Supp.2d 1024 (W.D. Wisc. 1999) (state law regulating operating subsidiaries of federal savings and loans found preempted under regulations of Office of Thrift Supervision). Those opinions offer little guidance, however, because those courts did not carefully examine Congressional intent with respect to the visitorial powers language in Section 484 of the Act.

B. Connecticut's Law Does Not Otherwise Conflict With Federal Law Because It Does Not Prevent Or Significantly Interfere With A National Bank's Exercise Of Its Powers

In the absence of Regulation 7.4006, there remains no conflict, for preemption purposes, between the Connecticut law at issue and federal banking law. The Supreme Court has made clear that states retain the power to regulate national banks where doing so "does not prevent or significantly interfere with the national bank's exercise of its powers." *See Barnett Bank of Morton County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996) (holding that federal law expressly allowing a national bank to sell insurance in small towns preempted a state law in direct conflict with federal law).[16] Connecticut's law, unlike the Florida statute in *Barnett*, certainly does not prohibit the Bank from conducting business through its operating subsidiary, nor does it substantially interfere with the exercise of that power.

The OCC itself is on record confirming that state licensing requirements and laws prohibiting abusive trade practices do not violate the *Barnett* standard because those types of state laws do not prevent national banks from exercising their

[16] When Congress passed the Gramm-Leach-Bliley Act in 1999, it expressly reaffirmed the *Barnett* standard. *See* H.R. Rep. No. 106-34, at 156-57 (1999), reprinted in 1999 U.S.C.C.A.N. 245, 251. The OCC's preemption regulations go beyond this standard, constituting further evidence that the OCC does not heed Congressional or judicial limits on the intended scope of federal preemption. *See, e.g.,* 12 C.F.R. § 7.4009 (preempting state laws that, to any degree, "obstruct, impair, or condition a national bank's ability to fully exercise its powers").

powers or significantly interfere with the exercise of those powers. *See* OCC Advisory Letter 96-8, at 3 (Oct. 8, 1996) (addressing permissible scope of state *insurance* laws).[17] In its recent preemption regulations, the OCC has adopted a far more aggressive preemption standard, one that cannot be reconciled with *Barnett* or with the agency's own prior interpretation. *See, e.g.,* 12 C.F.R. § 7.4008 (national bank may make real estate loans without regard to state licensing requirements). *But see First National Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775, 780 (8th Cir. 1990).

As far as legislative intent is concerned, the Connecticut law evidences none of the hostility toward national banks that originally animated Congress to pass the National Bank Act almost 150 years ago. Connecticut's law was enacted to protect consumers, not to sabotage the federal banking system, and it applies equally to mortgage lenders whether or not they are subsidiaries of a national bank or a state bank. *See Solomon v. Gilmore*, 731 A.2d 280, 287 (Conn. 1999) (secondary mortgage act is a remedial statute, passed to ensure that borrowers are protected from dishonest lenders); Conn. Gen. Stat. § 36a-487(1) (listing types of first mortgage lenders exempt from law); Conn. Gen. Stat. § 36a-512(4) (listing types of secondary mortgage lenders exempt from law). Such state laws, enacted to

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[17] *Available at:* http://www.occ.treas.gov/ftp/advisory/96-8.htm.

protect the public from fraudulent or abusive business practices, cannot be said to interfere with the *legitimate* exercise of any federally authorized banking power.

C. The OCC's Preemptive Approach Undermines Consumer Protection Without Advancing The Legitimate Interests Of The Federal Banking System

The OCC's preemptive approach to state regulation harms consumers by obstructing the efforts of state regulators to ensure that national banks and their operating subsidiaries treat members of the public fairly and honestly. This cost to consumers is wholly unnecessary because Connecticut's banking law, and similar state laws, do not threaten the continued vitality of the federal banking system. On the contrary, state regulation actually complements the OCC's effort to maintain the safety and soundness of the national banks. Congress could not have intended that the OCC would so severely undermine consumer protection, especially where doing so provides no countervailing benefits.

State regulation of banks enhances consumer protection in a multitude of ways, filling significant gaps in the OCC's ability to protect consumers. First, states have a clear mandate to protect consumers, which may be grounded in state banking law, as in Connecticut; in state consumer protection law administered by state attorneys general; or in state securities law. In contrast, the OCC's mandate is "To ensure the safety and soundness of the national banking system."[18] *See* Final Preemption Rule, 69 Fed. Reg. 1904, 1907 (Jan. 13, 2004) (OCC is charged with the fundamental responsibility of ensuring that national banks operate on a safe and sound basis). This function serves an important public purpose, but it should not and need not come at the expense of consumer protection.

State laws also offer regulatory tools not contained in federal banking law, which help protect bank customers without unduly burdening banks in the exercise of their powers. *See* Appellant's Opening Brief at 11-12 (ranging from licensing requirements to required disclosures). In addition, states bring much needed resources to the fight against lending abuses, in terms of both personnel and funding. For example, state banking agencies and state attorney generals employ nearly 700 full time examiners and attorneys to monitor and enforce consumer protection compliance, whereas the OCC investigates all consumer complaints against the country's 2150 national banks with a small fraction of that staff (about 5%) and a single customer assistance call center. *See* Gutierrez Amendment, *supra*, at 2.

[18] The OCC's core "Objectives," found on its website, also include such industry-oriented goals as "allowing banks to offer new products," and "reducing regulatory burden," but nowhere do they refer to protecting consumers from violations of the law. *See* OCC Homepage, "About the OCC," at 2, *available at:* http://www.occ.treas.gov/aboutocc.htm.

State regulators also serve as a valuable early warning system. Neither the OCC nor any other federal regulator can match the states' ability to detect and remedy illegal conduct in local communities. *See* Letter from Rep. Barney Frank to House Colleagues, "Safeguard State Consumer Laws" (Oct. 5, 2004) (promoting bill to curtail OCC preemption and stating "Congress recognizes that state enforcement authorities are in a far better position than any federal bank regulator to be directly accountable to their citizens.") (on file with author). *See also Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 38 (1980) ("[A]s a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern"). The value of this local presence is well-recognized in the securities field. *See The Role of State Securities Regulators in Protecting Investors: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs*, 108th Cong., 2d Sess. (June 2, 2004) (Statement of Joseph Borg, Director, Alabama Securities Commission, and Chair, NASAA Enforcement Section Committee) ("Because our local offices are often the first to receive complaints from investors, state securities regulators serve as an early warning system, working on the front lines, investigating potentially fraudulent activity, and alerting the public to the latest scams").[19]

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[19] *Available at:* http://www.nasaa.org/nasaa/abtnasaa/jpbtestimony.pdf.

States have a strong track record of enforcement in the banking field. In the area of abusive mortgage lending practices alone, state bank supervisory agencies initiated over 20,000 investigations in 2003 in response to consumer complaints, resulting in over 4,000 enforcement actions. *See* Gutierrez Amendment, *supra*, at 2; *see generally* Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 Ann. Rev. Banking & Fin. L. 225, 316, 348 (2004) and notes thereto. Among the more notable state achievements was the multi-state settlement with Household International, Inc., pursuant to which Household agreed to pay $484 million – a record amount in the lending area – for predatory loan practices. *See* Press Release, State of New York Banking Department, Statement of Superintendent McCaul on $484 Million Nationwide Settlement With Household International, Inc. (Dec. 17, 2002).[20]

The OCC's record, in contrast, includes few public enforcement actions during the last five years for lending and privacy abuses, and none during the last ten years against the eight largest national banks. *See* Wilmarth, 23 Ann. Rev. Banking & Fin. L. at 353-56. Indeed, the OCC has repeatedly sided *with* banks and *against* consumers or state law enforcement officials who were seeking redress for wrongful conduct or defending state regulation of banks. *See Wells Fargo*

[20] *Available at* http://www.banking.state.ny.us/pr021217.htm.

Bank of Texas, N.A. v. James, 321 F.3d 488, 495 (5th Cir. 2003) (OCC opposed Texas law prohibiting certain check cashing charges that disadvantaged low-income individuals and minorities); *Bank One Utah v. Guttau*, 190 F.3d 844, 849 (8th Cir. 1999) (OCC opposed Iowa law requiring ATM-related disclosures); Wilmarth, 23 Ann. Rev. Banking & Fin. L. at 353 (OCC defended FleetBank in class action alleging deceptive credit card practices); Jess Braven & Paul Beckett, *Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers*, Wall St. J., Jan. 28, 2002.

Even where a federal regulator has a strong commitment to enforcement and consumer protection, state regulators play a vital role in policing the industry. Such is the case in the securities field, where states have often led the effort to crack down on major frauds, not just locally but also on Wall Street. *See, e.g.*, Charles Gasparino, *The Stock-Research Pact: How Settlement Train Kept on Track*, Wall St. J., Dec. 23, 2002, at C1; *see also* Press Release, Office of the New York Attorney General, State Investigation Reveals Mutual Fund Fraud (Sept. 3, 2003).[21] The states' role is that much more vital in an area like banking, where the federal regulator – in this case the OCC – has neither the mandate nor the resources to protect the public adequately.

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[21] *Available at* http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html.

The need to preserve state regulation in the financial services area is clear. In the preamble to its final preemption rule, the OCC catalogued an array of societal trends that will inevitably strain regulatory and enforcement resources: technology has expanded the availability of credit; financing transactions now take hours not weeks; consumers can shop for investments online; the array of available products is expanding; and our society is increasingly mobile, with consumers seeking more financial services than ever before. *See* Final Preemption Rule, 69 Fed. Reg. 1904, 1908 (Jan. 13, 2004). Given these trends, it is the wrong time to limit the powers of state banking regulators.

The OCC's countervailing policy concerns do not justify a blanket prohibition against state regulation of national bank operating subsidiaries. State banking laws do not imperil the safety and soundness of national banks or their subsidiaries. Quite the opposite is true: to the extent states are permitted to regulate lenders in the interest of consumer protection, the OCC's resources can remain that much more focused on the agency's safety and soundness mandate. *See* Gutierrez Amendment (expressing concern of the House Financial Services Committee that the OCC's plan to redirect staff to compensate for the preempted state enforcement role "could weaken the OCC's ability to carry out its primary mission of ensuring the safety and soundness of the national bank system").

Moreover, preventing abuses helps limit liability to wronged customers, thus limiting depletion of bank resources.

Other frequently cited justifications for curbing state regulation are the need for uniformity and the need for protection against a generalized state hostility towards national banks. While a degree of uniformity in financial services regulation is certainly of value, to "invoke the concept . . . is not to prove its need." *See Atherton v. Federal Deposit Insurance Corp.*, 519 U.S. at 220. The Connecticut provisions at issue in this case, which deal with licensing, books and records requirements, and enforcement authority, *see Wachovia v. Burke,* 319 F. Supp. 2d at 278, do not create an unduly burdensome lack of uniformity either between state and federal law, or among the laws of the states. The record certainly does not substantiate such a claim.[22] While concerns about state hostility towards national banks may have been valid during the first century of our nation's history, the Supreme Court no longer credits that rationale. *See Atherton,* 519 U.S. at 220-21.[23]

[22] The only concrete burden cited by Amici American Bankers Association et al. is that states increasingly require individual loan officers to obtain licenses. *See* ABA Amicus brief at 18. Connecticut is not among those states, however. *Id.* More to the point, a regulatory regime requiring individual licenses for industry participants – at both the state and federal level – is eminently workable, without causing dire consequences for the industry, as demonstrated by the dual system of state and federal licensing requirements in the securities field.

[23] Because state regulation of national bank operating subsidiaries promotes consumer protection without compromising the policies that underlie federal

D. State Regulators' Jurisdiction To Protect Consumers And Investors Must Not Be Undermined By OCC Regulations

The OCC can be expected to continue attempting to limit state regulation to a degree never intended by Congress. The OCC has already significantly eroded the states' jurisdiction over national banks and their subsidiaries, to the detriment of consumers. Crucial to the OCC's success has been its ability to rewrite federal law through its rule-making process. Striking down rule 7.4006 in this case is therefore important not only to restore states' authority over national bank operating subsidiaries in the interest of consumer protection, but also to clarify that the OCC cannot restrict states' regulatory jurisdiction where Congress did not intend such restrictions.

The OCC's disregard for Congressional boundaries is illustrated not only in the preemptive regulations discussed above, but in other contexts as well. For example, in *Independent Insurance Agents of America, Inc. v. Hawke*, 211 F.3d 638 (D.C. Cir. 2000), the OCC had attempted to authorize all national banks to sell crop insurance, as an activity incidental to the business of banking under 12 U.S.C. § 24 (Seventh). Applying *Chevron*, the D.C. Circuit flatly rejected the OCC's attempt, holding that "Section 24 (Seventh) unambiguously does not authorize

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banking regulation, OCC rule 7.4006 cannot represent a "reasonable accommodation of manifestly competing interests" under the second prong of the *Chevron* test. *See Chevron,* 467 U.S. at 865.

national banks to engage in the general sale of insurance as 'incidental' to 'the business of banking.'" *Id.* at 644. The court relied chiefly on a section of the National Bank Act plainly granting the authority to sell insurance only to national banks located in small towns, defined as those with a population less than 5,000. *Id.* The court also cited the Gramm-Leach-Bliley provisions carefully delineating the permitted insurance activities of *financial subsidiaries* of national banks, not national banks themselves. *Id.* And the court highlighted two previous circuit court rulings against the OCC on the same legal issue. *Id.* Struck by the OCC's persistent disregard for the law, the court observed that the case was a "rerun" of the two prior appeals and stated that "[t]hough the OCC is surely familiar with its past defeats, it seems determined to repeat them." *Id.* at 642.

Permitting the OCC to rewrite federal law, as it did in *Independent Insurance Agents* and in rule 7.4006, raises the specter that the OCC will seek to exercise this power in other areas, including insurance and securities. Gramm-Leach-Bliley is abundantly clear in establishing the states' regulatory and enforcement jurisdiction over financial subsidiaries that engage in securities transactions. *See* 15 U.S.C. § 6701(f). The OCC has stated that its recent preemption regulations are not intended to "impinge upon the functional regulation framework that Congress set in place in the Gramm-Leach-Bliley Act." *See Comptroller Hawke Tells Senate Panel of Overarching Considerations for*

Preemption, Visitorial Powers, State News Service, Apr. 7, 2004, at 2, 2004 WL 73624998; *see also* 12 C.F.R. Sec. 7.4000(b)(1)(vi) (exclusive visitorial powers are subject to exception for laws authorizing states to "functionally regulate certain activities," as provided under Gramm-Leach-Bliley).

Concerns linger, however, that the OCC's regulations may still pose a long-term threat to functional regulation and that the OCC remains intent on becoming the nation's "dominant regulator, not only of banks but of a whole new class of financial institutions." *See* Sarah Borchersen-Keto, *OCC Banking Rules Come Under Scrutiny,* Compliance Headquarters, Feb. 2004 (quoting Diana Taylor, spokesperson for the Conference of State Bank Supervisors).[24] A number of developments are fueling these concerns. For example, fundamental disagreements have recently emerged between the OCC and the SEC over interpretations of Gramm-Leach-Bliley. The OCC has recently taken the position that the SEC should limit its oversight over bank broker-dealers, an area of regulation expressly granted to the SEC by Congress. On October 8, 2004, the OCC joined in a 40-page comment letter taking issue with the SEC's proposed rule that would implement the exceptions from the definition of "broker" that GLB provided for banks. *See* Letter from Alan Greenspan, Chairman, Board of

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[24] *Available at:* http://www.complianceheadquarters.com/Lending/Lending_Articles/occ_banking_rules.html.

Governors, Federal Reserve System; Donald E. Powell, Chairman, Federal Deposit Insurance Corporation; and John D. Hawke, Jr., Comptroller of the Currency, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Oct. 8, 2004.[25] The letter declares that the SEC's proposed rules "reflect a profound misinterpretation of the language and purposes of the 'broker' exceptions in the GLB Act." *Id.* at 2. The letter further complains that the rules would "impose a new, SEC-created regime of extraordinarily complex requirements and restrictions on long-standing banking functions" and would "insert the Commission to an unprecedented and unforeseen degree in the management of banks' internal operations." *Id.* It appears that the OCC will not submit quietly to functional regulation under Gramm-Leach-Bliley.

NASAA itself has publicly expressed concern that national banks might invoke the OCC's visitorial powers rule to impede investigations by state securities regulators relating to the securities activities of banks and their subsidiaries, even though such investigations are unquestionably permitted under GLB. *See* Letter from Christine A. Bruenn, NASAA President, to Office of the Comptroller of the Currency, Apr. 8, 2003 (national banks may misinterpret 7.4000(b)(2) and

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[25] *Available at* http://www.sec.gov/rules/proposed/s72604/frb100804.pdf.

conclude they need not cooperate with state securities investigators).[26] An OCC advisory letter, issued since Gramm-Leach-Bliley was enacted, lends credence to the point. *See* OCC Advisory Letter 2002-9 (Nov. 25, 2002).[27] In that letter, the OCC stresses the importance of limits on state visitorial powers and observes that even where federal statutes "specifically give enforcement authority to state attorneys general, . . . issues may arise as to the appropriate role of a state official with respect to a national bank's activities." *Id.* at 1 n.1. Presumably, the OCC would adhere to that same view with respect to state securities regulators, who are specifically given enforcement authority under Gramm-Leach-Bliley.

To the extent state securities regulators are precluded from fully exercising their regulatory and enforcement powers, the public will suffer, for NASAA members play a vital role in complementing federal securities regulation, just as state banking regulators play a vital role in complementing federal banking regulation.

CONCLUSION

For the reasons set forth above, the district court's ruling should be reversed.

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[26] *Available at:* http://www.nasaa.org/nasaa/scripts/fu_display_list.asp?start=25&ptid=15.

[27] *Available at: http://www.occ.treas.gov/ftp/advisory/2002-9.doc.*

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