

Remarks by
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One of the things I find so impressive about Women in Housing and Finance is the range of interests, occupations, and backgrounds of its members -- so very different from many of the industry organizations, comprising ever-narrower sub-specialties, with which we bank regulators spend so much of our time.

WHF, by contrast, has no political ax to grind or hidden agenda to advance. It brings together women -- and men -- who, apart from an association with the housing and financial industries, broadly defined, may be united primarily by respect for their mutual accomplishments -- and by the pleasure of each other's company.

By the same token, it is a genuine pleasure to be in your company today.

I want to speak today about a subject that has largely been the preserve of legal scholars and banking attorneys -- federal preemption, and, more specifically, the relationship between the U.S. Constitution and state laws that are intended by the states to be applicable to banks.

The OCC's role with respect to preemption was recently the subject of a lead article in the Wall Street Journal. The authors' thesis was that in supporting the preemption of state laws for the benefit of national banks, the OCC was reflecting an "anti-consumer" bias. Instead of going to court "to check the economic power of banking titans," as the Journal colorfully put it, the OCC has consistently defended national banks' claims of immunity from local laws intended to protect consumers.

Moreover, the authors argued, the OCC has aggressively supported the preemption of state laws in order to keep national banks, which, as we all know, pay two-and-one-half times more on average in supervisory fees than state banks, from converting to state charters.

Well, as often seems to be the case with such stories, the authors got it partly right and partly wrong.

There is no question that national banks' immunity from many state laws is a significant benefit of the national charter -- a benefit that the OCC has fought hard over the years to preserve. The ability of national banks to conduct a multistate business subject to a single uniform set of federal laws, under the supervision of a single regulator, free from visitorial powers of various state authorities, is a major advantage of the national charter.

To understand why Congress saw fit to create national banks as instruments of federal policy with this significant immunity from state authority, it's necessary to step back briefly in time.

Banks have never been the most popular of American institutions, and in the early days of the Republic, banks that operated under a broad grant of national authority may have been most unpopular of all. It was Jefferson who spoke for many of his generation when he said that "banking institutions are more dangerous than standing armies." Given what Americans had just been through at the hands of the British Army, that was saying quite a lot.

But even Jefferson conceded that if banks were an evil, they were a necessary one. That was the dilemma we've been wrestling with ever since.

In 1791, at the urging of Alexander Hamilton, Congress created the First Bank of the United States -- our first venture into the area of central banking. When the Bank's 20-year charter expired, the Bank expired with it. But a crumbling economy led lawmakers five years

later to create the Second Bank of the United States, which proved no more popular than the first. And state-chartered banks, of which there were well over a hundred by 1816, took advantage of that unpopularity by encouraging state legislatures to pass a variety of discriminatory laws, hoping to rein in, if not destroy, the sometimes overbearing Second Bank.

Maryland's contribution was an annual tax of \$15,000 levied against its Baltimore branch. When the bank refused to pay, it was successfully sued in state court. In the name of its cashier, J.W. McCulloch, the Second Bank appealed that verdict to the U.S. Supreme Court.

What emerged was one of the landmark decisions in our history. Speaking for a unanimous court, Chief Justice Marshall declared constitutional Congress's creation of a national bank and declared unconstitutional Maryland's attempt to weaken it through taxation. On the first point, Marshall elaborated the "loose constructionist" view of federal power associated with Hamilton, an expansive view based on a strong union.

On the second point, regarding Maryland's attack on the Second Bank, Marshall invoked the Supremacy Clause -- paragraph 2 of article VI -- holding that the Constitution of the United States, and the laws promulgated under it, are the law of the land and carry a presumption of supremacy over the states. "The States," Marshall affirmed, "have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control the operations" of any agency created by lawful exercise of federal authority.

Of course, the states could still send elected representatives to Washington to accomplish the same end by federal legislation or presidential authority, and under President Andrew Jackson, legislation to extend the life of the Second Bank was vetoed.

With the loss of this centralizing and stabilizing influence, the U.S. banking system stumbled into near-anarchy. Indeed, one is hard pressed to call it a system at all, because

standards and practices varied enormously from state to state. In states like Indiana and New York, new bank organizers were required to have real capital, and their operations were subject at least to some degree of government supervision. But in many states, banks could organize without a dollar's capital to their name, and supervision was virtually nonexistent. That permitted the shadiest of operators to enter the field -- and dominate it in some states.

The currency of the country consisted of notes issued by those banks, and the practice of issuing bank notes with no or inadequate real assets backing them up became a national scandal -- and a huge burden on interstate commerce, which depended on a reliable currency. To keep redemption-minded note-holders at a safe distance, bank operators became experts at evasion, moving their hole-in-the-wall offices to frontier backwaters "where only the wildcats roamed." Thus did the Wildcat Era in banking acquire its name.

Like most such characterizations, this one was unfair to the outliers -- responsible bankers, in this case, of whom there were many. But the lack of uniformity in the value of currency was itself a great flaw in the nation's banking before the Civil War, because it gave rise to confusion and uncertainty -- two major obstacles to economic development.

This situation cried out for a remedy, and the Civil War-era Congress supplied one that served two important objectives: first bringing uniformity to the currency; second, financing the Civil War. The Office of the Comptroller of the Currency was created to charter and supervise national banks, which would serve as the instruments of a uniform and secure national currency, and help stabilize and support the national economy.

When the Comptroller chartered a new national bank, a portion of the bank's paid-in capital was used to purchase Treasury securities, which not only filled the Union's coffers, but

which was pledged as backing for circulating notes issued by the banks with the Comptroller's approval.

Operating under a broad and potent grant of enumerated powers and such “incidental powers as shall be necessary to carry on the business of banking,” the national banks were designed from the outset to carry on their business under uniform rules, uniformly high standards, and uniform federal supervision. And their notes, backed by government obligations, would circulate at uniform value.

Another feature of national banking was its uniformly national character. Initially the offer of easy conversion to the national charter was expected to provide sufficient incentive for state banking to liquidate itself. But the lagging pace of voluntary conversions led Congress to adopt the Marshall dictum so nicely expressed in the McCulloch case -- “the power to tax is the power to destroy.” It imposed a “death tax” on the notes of state banks, a tax that congressional backers promised would be every bit as effective in driving out state banks as an outright ban, which was also considered.

Of course, they were wrong. State banking was able to adapt simply by substituting deposit-taking for note-issuing, and by taking advantage of state regulations deliberately tailored to permit them to engage in many activities deemed too risky for national banks.

The dual banking system was thus born -- not in fulfillment of a national plan, clearly, but in spite of it. Reflecting the country’s basic ambivalence about banking and the use of national power, a less confrontational Congress reconciled itself over time to a dual banking system rather than a unified one, embracing a more benign view of state banking as a legitimate expression of state sovereignty and a source of salutary competition for national banks.

With this outcome, the stage was set for future federal-state tensions. First, states sought to determine how much control, if any, they would have over the powerful new federal financial institutions that operated within their borders. Second, as the sponsors and at least nominal supervisors of state banks, they had a material interest in ensuring that those banks remained competitive -- through positive grants of powers and privileges and, if possible, through limits on the powers and privileges of their national competitors.

The courts quickly decided that there were limits to the immunity from state law conferred by the national bank charter. For instance, in McClellan v. Chipman, an 1896 case, the Supreme Court upheld the right of the states to regulate contracts involving a national bank. It also affirmed the state's authority to regulate the transfer of real property. In Anderson National Bank v. Lockett of 1943, it rejected a bank's claim that it was not subject to state escheat laws.

In later years Congress in some cases adopted state law as the reference point for some national bank powers, as it did in the 1927 McFadden Act, setting out the branching authority of national banks.

On the other hand, in an overwhelming body of case law built up since the enactment of the National Bank Act, the courts, echoing McCulloch v. Maryland, have been emphatic about where the states may not go. State laws may not "stand as an obstacle" to the accomplishment of the purposes for which Congress created the national bank charter.

The states may not "prevent or significantly interfere with" the activities lawfully engaged in by national banks. They may not "impair" or "prevent" national banks from exercising congressionally granted powers. They may not regulate at all in areas in which the federal interest predominates or where Congress has "occupied the field" to the exclusion of the states.

Decisions of the Supreme Court have overwhelmingly endorsed the preemption doctrine as it applies to national banks -- a record of consistency that transcends changes in the political or philosophical makeup of the Court.

In Davis v. Elmira Savings Bank, an 1896 case, the Court rejected an attempt to give preference to a state institution's claim on an insolvent national bank, while in 1954, in Franklin National Bank v. New York, the Court ruled that a state could not regulate a national bank's advertising campaign.

In Barnett v. Nelson, the Court in 1996 once again enjoined the states from erecting obstacles to "the accomplishment and execution of the full purposes and objectives of Congress." In that case, the Court found that a Florida state law barring national banks from selling insurance in small towns was in "irreconcilable conflict" with the National Bank Act, and was thus preempted.

While the OCC has no self-executing power to preempt state law, it has on many occasions expressed opinions about the preemptive effect of federal law. In recent years, for example, we have opined that state laws that impose restrictions on such financial activities as ATM fees, auctions, and trust services cannot lawfully apply to national banks.

The consequences of these decisions has been to preserve and protect a national banking system operating under unified federal supervision. The rationale for such a system is as compelling today as it was in 1863.

That's certainly true for the ever-growing number of business and retail customers who benefit from access to nationwide banking services. It is doubly true for the multistate and nationwide banking organizations who serve them.

In 1863, as I've already mentioned, state supervision, with few exceptions, was nonexistent or worse. Today each of the fifty states and the District of Columbia have active supervisory schemes in place, based on impressive foundations of laws and regulations singularly theirs. In addition, the Federal Reserve and the FDIC, as major players on the supervisory scene, devote thousands of examiners to the supervision of state chartered banks.

To be sure, state supervisors have responded admirably to the needs of a multistate environment, through a master agreement allocating primary supervisory authority for state banks with interstate branches. Nonetheless, the national bank charter remains the most efficient means of conducting broad interstate banking activities.

It's important to note that, for better or worse, the preemption doctrine is value-blind and agnostic with respect to the desirability of the state law involved. In preemption situations, the only relevant issue is whether the state law would impair or significantly interfere with a national bank's exercise of powers granted to it under federal law. If such an impact is found to exist, federal law must prevail. Any opinions we might have about the desirability or merit of the laws in question are not relevant.

Let me give you a hypothetical example. I have long been convinced, going back to my days as Under Secretary of the Treasury for Domestic Finance, that many of our concerns about the "unbanked" could be well addressed through effective use of technology. I have repeatedly urged banks to offer low-cost electronic, direct-deposit, debit card-based banking accounts to low- and moderate-income Americans, hoping to help break their dependence on check-cashers, payday lenders, and other higher-cost financial providers.

Now let's say that a state chose to pass a law requiring all banks to offer such electronic accounts, defining the nature of the account and imposing a fee cap. I would applaud that action

by the states. I would encourage Congress to follow suit. But until it did, I would also have no choice but to hold national banks immune from such a law. Under prevailing rules of preemption, the states simply do not have the authority to order national banks to offer specific types of accounts or to regulate what they charge for services.

While some might view such a position in this hypothetical case as "anti-consumer," I would caution against such simplistic characterizations. Take the case of those local laws that have sought to bar banks from imposing charges for the use of ATMs by persons who do not maintain an account with them -- the so-called ATM surcharge laws. Such laws have an undoubted political appeal -- given a choice, most people would naturally prefer not to pay a charge for using an ATM, regardless of who owns it.

But a major incentive for banks to deploy ATMs is the expectation of profit from the use of their terminals by noncustomers. Thus, terminal deployers seek out new locations for their ATMs in the hope that many people will find it convenient to use their terminals --either paying a fee for the privilege or becoming a customer to enjoy free use of the ATM.

Noncustomers clearly benefit from the increased deployment of ATMs by banks seeking fees, and would clearly be less well off if anti-surcharge laws diminished the incentives of such banks to seek out new users.

Not only are such laws preempted by federal law, as the courts have consistently held, but they are fundamentally wrong-headed, pretending to help consumers when in fact they do quite the opposite. There is no clearer evidence of this than the dramatic increase in ATM deployment that occurred after the ATM networks abandoned their own rules barring such surcharges.

Let me raise one other caution about preemption. The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.

We have recently seen several instances in which nonbank lenders who would otherwise have been fully subject to various state regulatory laws have sought to rent out the preemption privileges of a national bank to evade such laws. Indeed, the payday lending industry has expressly promoted such a "national bank strategy" as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempts to clothe itself with the status of an "agent" of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank.

Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender. As you probably saw, we recently took supervisory action against a small national bank that dramatically demonstrated its inability to manage such a relationship in a safe and sound manner.

Finally, let me say a few more words about the role that the OCC plays in consumer protection. Even if one were to view all state enactments in this area as "pro-consumer," and all OCC support for preemption as "anti-consumer," that simplistic view of life ignores the fact that the overwhelming volume of consumer protections for bank customers have come from federal laws that are clearly applicable to national banks. We conscientiously enforce all of those laws.

In fact, we have more than 300 examiners who spend all or part of their time on consumer protection compliance.

And I think we have played a real leadership role in this regard. Not long ago we required one large credit card bank to make restitution payments of at least \$ 300 million for overreaching against consumers. We have asserted the authority to use our cease-and-desist powers to remedy unfair and deceptive practices that violate the Federal Trade Commission Act, and that authority has been recognized in court. And, as I have already mentioned, we recently forced a national bank to take steps to exit the payday lending business. We take tremendous pride in delivering a high level of protection to consumers without subjecting national banks to excessive -- and costly -- regulatory burden.

One can hardly think of two subjects that have aroused more intense feeling in our history than banking and the relationship between the federal government and the states. It is a matter of historical fact that emotions ran almost as high in the war against the two Banks of the United States -- and war is the metaphor that was almost always used in describing those events - - as they did in the all too literal war Americans fought against each other some years later. It seems fitting that the national banking system was one of the byproducts of that conflict.

These two epic issues -- banking and federalism -- converge in the preemption question. In that sense, it's not surprising that preemption -- on one level, an abstruse legal concept -- is still capable of generating passionate controversy. But we cannot allow our emotions to rule when it comes to public policy. Balance, sober judgment, and perspective are all crucial. And for that we rely not only on those who govern, but also on an informed, responsible -- and historically-literate -- citizenry.