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Remarks of
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I appreciate the opportunity to be part of this program on federal preemption.

I would like to make three brief observations about preemption. First, I would like to suggest that the debate over the impact of preemption on the dual banking system is due to the fact that the states and the OCC view the purpose of the dual banking system differently.

Second, I would like to suggest that the concerns of the states over the recent preemption actions taken by the OCC are misdirected. The dual banking system is not jeopardized by the National Bank Act or the OCC, but by other federal laws, specifically the Federal Deposit Insurance Act and the Bank Holding Company Act.

Finally, I would like to propose that we may have reached a point where there is an economic rationale for a broader application of national laws and preemption to the financial services industry.

Conflicting Views of the Dual Banking System

In preparation for this program, I reviewed the CSBS comments to the OCC on its proposed preemption regulations, and I read a paper released by the OCC entitled "National Banks and the Dual Banking System".

I found that the CSBS and the OCC hold fundamentally different views of the purpose of the dual banking system.

The CSBS submission maintains that, through a series of amendments to the National Bank Act, Congress sought to erect a dual banking system based upon a "policy of equalization", which was intended to "preserve a basic parity of competitive opportunities between national and state banks."

In support of this view, CSBS cites a 1966 Supreme Court case, and a 1984 report prepared under the direction of then Vice President George Bush.

In contrast, the OCC paper characterizes the dual banking system as two separate, and independent chartering and regulatory systems that are defined by their differences, not their similarities.

In support of its view of the dual banking system, the OCC cites various Supreme Court decisions, and a 1977 analysis of the dual banking system by Professor Kenneth Scott, in which Professor Scott states that the "very core" of the dual banking system is the "simultaneous existence of different regulatory options that are not alike".

These divergent views of the dual banking system have a direct impact on how the states and the OCC perceive the doctrine of federal preemption.

For the OCC, preemption is a means to maintain the integrity of the two independent regulatory systems. Preemption prevents the states from imposing inappropriate conditions or limitations on the operations of national banks.

For the states, preemption disrupts the balance of the dual banking system. It allows national banks to avoid state laws, and potentially gain a competitive advantage over state banks.

Can these divergent views be reconciled? Maybe.

I recently read several Supreme Court decisions related to the preemptive power of the National Bank Act, and, in my opinion, the OCC is correct when it concludes that the National Bank Act, and the Supreme Court cases decided in the 140 years since the passage of that Act, limit state power over national banks.

At the same time, CSBS is correct when it notes that Congress has periodically amended the National Bank Act to maintain a competitive balance between national banks and state banks.

The common ground between these views may be that federal preemption does not bar the states from addressing any competitive imbalance that may result from preemption.

In those cases in which states laws are preempted, the states retain the ability to achieve regulatory "equalization" simply by repealing the application of a preempted law on state banks.

Georgia did just that after the OCC issued a preemption order related to a Georgia fair lending statute.

Some states may decide not to exercise this right, especially if they conclude that the purpose of the preempted law is more important than the policy of competitive equality between state and national banks. Nonetheless, that decision rests with the states. If they want equality – they can have it.

<u>The Impact of Other Federal Laws on the Dual Banking System</u>

There is, however, more to this story. I suspect that the reason states emphasize a policy of equalization over a policy of distinction is because Congress has diminished their ability to distinguish state banks from national banks.

The ability of the states to distinguish their banks from national banks has been eroded not by the National Bank Act or any actions by the OCC, but as a direct result of other federal laws, specifically the Federal Deposit Insurance Act and the Bank Holding Company Act.

Since the demise of state deposit insurance systems, all state banks have become subject to the Federal Deposit Insurance Act.

That Act imposes a host of conditions on state banks, including a prohibition on the ability of state banks to engage in activities, as a principal, that are not permissible for national banks

The Bank Holding Company Act also places restrictions on state banks. It limits the scope of affiliations permissible for state banks.

If states were truly free to determine what activities and affiliations were appropriate for their banks, they might not be so focused on the policy of equalization or so upset with the doctrine of federal preemption.

I am not so naïve as to assume that it would be easy to reverse the application of deposit insurance to state banks or to repeal the application of the Bank Holding Company Act to state banks.

I raise the impact of these other federal laws simply to suggest that the real threat to the dual banking system is not the National Bank Act or the OCC, but these other federal laws.

Applying the Doctrine of Federal Preemption to the Financial Services Industry

Finally, I wonder if we have reached a point in the development of the financial services industry where it is appropriate for Congress to pursue a broader policy of national laws, backed explicitly or implicitly by preemption, for the financial services industry.

The case for a broader application of national laws for the financial services industry would be an economic one, not a legal one.

Under the terms of the Supremacy Clause and the Commerce Clause, there is no doubt that Congress can decide to override state regulation of financial services firms.

The question is should it?

Over the years, Congress has decided to establish national standards in areas deemed important to the citizens and the economy, as a whole. For example, we have national laws in the areas of prescription drugs, food inspections, retirement programs, and airline safety. In each of these areas, Congress determined that there was a federal interest that superceded the regulatory interests of individual states.

I will leave it to economists to make the case that financial products and services fall into this special category. I suspect, however, that such a case can be made for products and services that are sold in national markets and that have a significant impact on the economy.

Thank you.