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# Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress

May 17, 2019

**Congressional Research Service**

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R45726



R45726

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## Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress

Banks play a critical role in the United States economy, channeling money from savers to borrowers and facilitating productive investment. While the nature of lawmakers' interest in bank regulation has shifted over time, most bank regulations fall into one of three general categories.

First, banks must abide by a variety of *safety-and-soundness* requirements designed to minimize the risk of their failure and maintain macroeconomic stability. Second, banks must comply with *consumer protection* rules intended to deter abusive practices and provide consumers with complete information about financial products and services. Third, banks are subject to various *reporting*, *recordkeeping*, and *anti-money laundering* requirements designed to assist law enforcement in investigating criminal activity.

The substantive content of these requirements remains the subject of intense debate. However, the division of regulatory authority over banks between the federal government and the states plays a key role in shaping that content. In some cases, federal law displaces (or “preempts”) state bank regulations. In other cases, states are permitted to supplement federal regulations with different, sometimes stricter requirements. Because of its substantive implications, federal preemption has recently become a flashpoint in debates surrounding bank regulation.

In the American “dual banking system,” banks can apply for a national charter from the Office of the Comptroller of the Currency (OCC) or a state charter from a state’s banking authority. A bank’s choice of chartering authority is also a choice of primary regulator, as the OCC serves as the primary regulator of national banks and state regulatory agencies serve as the primary regulators of state-chartered banks. However, the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) also play an important role in bank regulation. The Federal Reserve supervises all national banks and state-chartered banks that become members of the Federal Reserve System (FRS), while the FDIC supervises all state banks that do not become members of the FRS. This complex regulatory architecture has resulted in a “symbiotic system” with both federal regulation of state banks and state regulation of national banks. In the modern dual banking system, national banks are often subject to generally applicable state laws, and state banks are subject to both generally applicable federal laws and regulations imposed by their federal regulators. The evolution of this system during the 20th century caused the regulation of national banks and state banks to converge in a number of important ways.

However, despite this convergence, federal preemption provides national banks with certain unique advantages. In *Barnett Bank of Marion County, N.A. v. Nelson*, the Supreme Court held that the National Bank Act (NBA) preempts state laws that “significantly interfere” with the powers of national banks. The Court has also issued two decisions on the preemptive scope of a provision of the NBA limiting states’ “visitorial powers” over national banks. Finally, OCC rules have taken a broad view of the preemptive effects of the NBA, limiting the ways in which states can regulate national banks.

Courts, regulators, and legislators have recently confronted a number of issues involving banking preemption and related federalism questions. Specifically, Congress has considered legislation that would overturn a line of judicial decisions concerning the circumstances in which non-banks can benefit from federal preemption of state usury laws. The OCC has also announced its intention to grant national bank charters to certain financial technology (FinTech) companies—a decision that is currently being litigated. Finally, Congress has recently turned its attention to the banking industry’s response to state efforts to legalize and regulate marijuana.

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Banks play a critical role in the United States economy, channeling money from savers to borrowers and facilitating productive investment.<sup>1</sup> Among other things, banks provide loans to businesses, help individuals finance purchases of cars and homes, and offer services such as checking and savings accounts, debit cards, and ATMs.<sup>2</sup> In addition to occupying a central role in the American economy, the banking industry is a perennial subject of political interest.<sup>3</sup> While the nature of lawmakers' interest in bank regulation has shifted over time, most bank regulations fall into one of three general categories. First, banks must abide by a variety of *safety-and-soundness* requirements designed to minimize the risk of their failure and maintain macroeconomic stability.<sup>4</sup> Second, banks must comply with *consumer protection* rules intended to deter abusive practices and provide consumers with complete information about financial products and services.<sup>5</sup> Third, banks are subject to various *reporting, recordkeeping, and anti-money laundering* requirements designed to assist law enforcement in investigating criminal activity.<sup>6</sup>

The substantive content of these requirements remains the subject of intense debate.<sup>7</sup> However, the division of regulatory authority over banks between the federal government and the states plays a key role in shaping that content. In some cases, federal law displaces (or “preempts”) state bank regulations. In other cases, states are permitted to supplement federal regulations with different, sometimes stricter requirements. Because of its substantive implications, federal preemption has recently become a “flashpoint” in debates surrounding bank regulation,<sup>8</sup> with one commentator observing that preemption is “[t]he issue at the center of most disputes between state and federal banking regulators.”<sup>9</sup>

This report provides an overview of banking preemption. First, the report discusses general principles of federal preemption. Second, the report provides a brief history of the American “dual banking system.” Third, the report discusses the Supreme Court’s decision in *Barnett Bank of Marion County, N.A. v. Nelson*, where the Court held that federal law preempts state laws that “significantly interfere” with the powers of national banks.<sup>10</sup> Fourth, the report reviews two Supreme Court decisions concerning the extent to which states may exercise “visitorial powers” over national banks. Fifth, the report discusses the Office of the Comptroller of the Currency’s (OCC’s) preemption rules and provisions in the Dodd-Frank Wall Street Reform and Consumer

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<sup>1</sup> FREDERIC S. MISHKIN, *THE ECONOMICS OF MONEY, BANKING, AND FINANCIAL MARKETS* 232 (11th ed. 2016).

<sup>2</sup> *Id.*

<sup>3</sup> *See generally* GRETCHEN RITTER, *GOLDBUGS AND GREENBACKS: THE ANTIMONOPOLY TRADITION AND THE POLITICS OF FINANCE IN AMERICA, 1865-1896* (1997); RICHARD T. McCULLEY, *BANKS AND POLITICS DURING THE PROGRESSIVE ERA: THE ORIGINS OF THE FEDERAL RESERVE SYSTEM, 1897-1913* (1992); BRAY HAMMOND, *BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR* (1991); JOHN M. McFAUL, *THE POLITICS OF JACKSONIAN FINANCE* (1972); Roderick M. Hills, Jr., *Exorcising McCulloch: The Conflict-Ridden History of American Banking Nationalism and Dodd-Frank Preemption*, 161 U. PA. L. REV. 1235 (2013); CRS Report R42081, *Finance and the Economy: Occupy Wall Street in Historical Perspective*, by Sean M. Hoskins.

<sup>4</sup> RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, *THE LAW OF FINANCIAL INSTITUTIONS* 199-296 (6th ed. 2017).

<sup>5</sup> *Id.* at 447-585.

<sup>6</sup> *Id.* at 587-618.

<sup>7</sup> *See, e.g.*, Alan Rappeport, *Senate Advances Bill to Loosen Banking Rules, Revealing Democratic Split*, N.Y. TIMES (Mar. 6, 2018), <https://www.nytimes.com/2018/03/06/us/politics/senate-vote-bank-regulation-dodd-frank.html>.

<sup>8</sup> V. Gerard Comizio & Helen Y. Lee, *Understanding the Federal Preemption Debate and a Potential Uniformity Solution*, 6 BUS. L. BRIEF 51, 51 (2010).

<sup>9</sup> Andrew T. Reardon, *An Examination of Recent Preemption Issues in Banking Law*, 90 IOWA L. REV. 347, 355 (2004).

<sup>10</sup> 517 U.S. 25 (1996).

Protection Act concerning the preemption of state consumer protection laws. Finally, the report outlines a number of current issues in banking preemption, including (1) the extent to which non-banks can benefit from federal preemption of state usury laws, (2) the OCC's decision to grant special purpose national bank charters to financial technology (FinTech) companies, and (3) proposals to provide legal protections to banks serving marijuana businesses that comply with state law.

## Background

### Preemption Doctrine

The doctrine of federal preemption is grounded in the Supremacy Clause of Article VI of the Constitution, which provides that “the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”<sup>11</sup> The Supreme Court has explained that “under the Supremacy Clause . . . any state law, however clearly within a State’s acknowledged power, which interferes with or is contrary to federal law, must yield.”<sup>12</sup>

The Court has identified two general ways in which federal law can preempt state law. Federal law can *expressly* preempt state law when a federal statute or regulation contains explicit preemptive language—that is, where a clause in the relevant federal statute or regulation explicitly provides that federal law displaces certain categories of state law.<sup>13</sup> The Employee Retirement Income Security Act, for example, contains a preemption clause providing that some of the Act’s provisions “shall supersede any and all State laws insofar as they may now or hereafter relate to any [regulated] employee benefit plan.”<sup>14</sup>

Federal law can also *impliedly* preempt state law “when Congress’ command is . . . implicitly contained in” the relevant federal law’s “structure and purpose.”<sup>15</sup> The Supreme Court has identified two subcategories of implied preemption. First, “field preemption” occurs “where [a] scheme of federal regulation is so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.”<sup>16</sup> Second, “conflict preemption” occurs where “compliance with both federal and state regulations is a physical impossibility,”<sup>17</sup> or where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>18</sup> In *Crosby v. National Foreign Trade Council*, for example, the Court held that a federal law imposing sanctions on Burma impliedly preempted a Massachusetts law that prohibited state entities from doing business with Burma.<sup>19</sup> The Court reached this conclusion after determining that the state statute posed an obstacle to the federal statute’s purposes of (1) providing the President with “flexible” authority over sanctions policy, (2) limiting economic pressure against the Burmese government to the specific range reflected in the

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<sup>11</sup> U.S. CONST. art. VI, cl. 2.

<sup>12</sup> *Gade v. Nat’l Solid Wastes Mgmt. Assn.*, 505 U.S. 88, 108 (1992) (internal quotation marks and citation omitted).

<sup>13</sup> *Id.* at 98.

<sup>14</sup> 29 U.S.C. § 1144(a).

<sup>15</sup> *Gade*, 505 U.S. at 98 (internal quotation marks and citation omitted).

<sup>16</sup> *Id.*

<sup>17</sup> *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963).

<sup>18</sup> *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

<sup>19</sup> 530 U.S. 363, 388 (2000).

federal statute, and (3) granting the President the ability to speak for the country “with one voice.”<sup>20</sup>

Some federal banking laws expressly preempt state law. Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, for example, expressly grants federally insured state banks the right to charge the highest interest rate allowed by the states in which they are located, even when lending to borrowers in other states with stricter usury laws.<sup>21</sup> Other federal banking laws impliedly preempt state law. Specifically, the Supreme Court has held that the National Bank Act impliedly preempts state laws that “significantly interfere” with the powers of national banks.<sup>22</sup> However, *all* banking preemption issues are heavily influenced by the regulatory architecture surrounding the banking system. The following section of the report accordingly outlines the development of the American “dual banking system.”

## The Origins and Evolution of the Dual Banking System

### The First and Second Banks of the United States

Disputes over the federal government’s role in regulating the financial system have been a feature of American politics since the country’s inception. In 1791, Congress approved the creation of the First Bank of the United States over fierce opposition from many of the nation’s leaders, including James Madison and Thomas Jefferson.<sup>23</sup> In addition to accepting deposits and making loans to the public, the First Bank acted as the federal government’s fiscal agent by collecting tax revenues, securing the government’s funds, and paying the government’s bills.<sup>24</sup> The First Bank’s proponents argued that the Bank would facilitate economic growth by extending credit to private businesses and establishing a uniform national currency in the form of the Bank’s notes.<sup>25</sup> By contrast, the First Bank’s critics argued that the concentration of financial power in a single federal institution threatened state sovereignty and undermined the operations of state-chartered banks.<sup>26</sup> This debate culminated in a victory for the First Bank’s critics when Congress refused to renew the Bank’s charter by a single vote in 1811.<sup>27</sup>

But disputes over the federal government’s role in the banking system did not end with the demise of the First Bank. After the War of 1812 generated significant economic turmoil, Congress chartered the Second Bank of the United States for a twenty-year term in 1816.<sup>28</sup> The Second Bank performed many of the same functions as the First Bank and attracted similar criticism,

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<sup>20</sup> *Id.* at 374-86.

<sup>21</sup> 12 U.S.C. § 1831d(a).

<sup>22</sup> *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996).

<sup>23</sup> See MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, *FINANCIAL REGULATION: LAW AND POLICY* 35 (2d ed. 2018); THE FIRST BANK OF THE UNITED STATES: A CHAPTER IN THE HISTORY OF CENTRAL BANKING, FED. RES. BANK OF PHILADELPHIA 2-4 (June 2009), <https://www.philadelphiafed.org/-/media/publications/economic-education/first-bank.pdf>.

<sup>24</sup> BARR, ET AL., *supra* note 23, at 36-37; THE FIRST BANK OF THE UNITED STATES, *supra* note 22, at 5.

<sup>25</sup> THE FIRST BANK OF THE UNITED STATES, *supra* note 23, at 8.

<sup>26</sup> *Id.* at 10.

<sup>27</sup> *Id.* at 5.

<sup>28</sup> BARR, ET AL., *supra* note 23, at 36-37. The Supreme Court famously held that Congress possessed the constitutional authority to incorporate the Second Bank of the United States in its 1819 decision in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).

eventually becoming the target of populist fury led by President Andrew Jackson.<sup>29</sup> In 1832, President Jackson vetoed legislation to extend the Second Bank’s charter, leading to its demise in 1836.<sup>30</sup>

### The Free Banking Era

After the Second Bank’s charter expired, bank regulation was wholly entrusted to the states. Inspired by the Jacksonian attack on concentrated economic power, a number of states dispensed with the requirement that banks obtain a charter via a special act of the state legislature.<sup>31</sup> Instead, banks in these states could obtain charters from state banking authorities as long as they met certain general conditions.<sup>32</sup> During this “Free Banking era,” the country lacked a uniform national currency and relied instead on notes issued by state banks, which circulated at a discount from their face value that reflected the issuing bank’s location and credit quality.<sup>33</sup> In some states, so-called “wildcat banks” in remote areas issued notes back by minimal specie (gold or silver), assuming that noteholders would be unlikely to travel long distances to redeem them.<sup>34</sup> These wildcat banks failed at a far higher rate than their urban rivals.<sup>35</sup> Economic historians continue to debate the merits and drawbacks of the Free Banking era. According to the standard narrative, Free Banking was largely a failure, resulting in a large number of bank failures, financial instability, and inefficiencies that accompanied a heterogeneous currency.<sup>36</sup> However, a number of revisionist scholars have questioned this assessment, arguing that despite the high rate of bank failures during the Free Banking Era, total losses to bank noteholders during the period were in fact relatively small.<sup>37</sup>

### The Creation of the Dual Banking System

Whatever its virtues and vices, the Free Banking Era came to an end during the Civil War. After the Treasury Department’s efforts to finance the war by borrowing from Northern banks led to a shortage in specie, Congress enacted the National Currency Act in 1863 and the National Bank Act (NBA) in 1864.<sup>38</sup> Under the Acts, banks were offered the opportunity to apply for a national charter from the newly created OCC, creating a “dual banking system” in which both the federal government and the states chartered and regulated banks.<sup>39</sup> As a condition of obtaining a national charter, the Acts required banks to purchase United States government bonds, giving the federal government a new source of revenue to fight the war.<sup>40</sup> Once national banks deposited those bonds with the federal government, they were allowed to issue national banknotes up to 90 percent of the market value of their bonds.<sup>41</sup> These national banknotes functioned as a uniform

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<sup>29</sup> BARR, ET AL., *supra* note 23, at 37-38.

<sup>30</sup> *Id.*

<sup>31</sup> CARNELL, ET AL., *supra* note 4, at 9.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 10.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> BARR, ET AL., *supra* note 23, at 39-40.

<sup>39</sup> *Id.* at 40-41.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

national currency and gave the federal government significant control over the nation's money supply.<sup>42</sup>

The creation of a dual banking system was not intended by the proponents of the NBA, who assumed that all state-chartered banks would convert to national charters.<sup>43</sup> In order to incentivize state-chartered banks to make this switch, Congress enacted a ten percent tax on state banknotes in 1865.<sup>44</sup> But the tax did not accomplish its intended purpose. While the number of state-chartered banks fell significantly after the enactment of the NBA, state banks eventually skirted this tax by issuing paper checks in lieu of banknotes.<sup>45</sup> And in the late 19th century, state banking authorities contributed to this regulatory arbitrage by offering their banks laxer regulations than the OCC.<sup>46</sup> As a result, state-chartered banks have outnumbered national banks since 1895, and the dual banking system has survived to this day.<sup>47</sup>

Under the contemporary dual banking system, the OCC serves as the primary regulator of national banks and has broad powers to regulate their organization,<sup>48</sup> examination,<sup>49</sup> and operations.<sup>50</sup> Section 24 of the NBA grants national banks a number of powers, including: (1) “discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt,” (2) “receiving deposits,” (3) “buying and selling exchange, coin, and bullion,” (4) “loaning money on personal security,” and (5) “obtaining, issuing, and circulating notes.”<sup>51</sup> Section 24 also grants national banks “all such incidental powers as shall be necessary to carry on the business of banking.”<sup>52</sup> Federal court and OCC decisions have identified roughly 80 activities that fall within the “incidental powers” of national banks, including the ability to broker annuities charge customers non-interest fees.<sup>53</sup>

By contrast, state banking authorities are the primary regulators of state-chartered banks.<sup>54</sup> While state banking laws are by no means uniform, they typically provide state-chartered banks with the power to engage in activities similar to those listed in the NBA and activities that are “incidental to the business of banking.”<sup>55</sup>

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<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> See *Veazie Bank v. Fenno*, 75 U.S. 533 (1869) (upholding the federal tax on state banknotes).

<sup>45</sup> CARNELL, ET AL., *supra* note 4, at 9.

<sup>46</sup> *Id.* at 12; BARR, ET AL., *supra* note 23, at 36-37.

<sup>47</sup> BARR, ET AL., *supra* note 23, at 41.

<sup>48</sup> 12 U.S.C. §§ 21, 26.

<sup>49</sup> *Id.* § 481.

<sup>50</sup> *Id.* §§ 81-92a.

<sup>51</sup> *Id.* § 24.

<sup>52</sup> *Id.*

<sup>53</sup> See Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renaissance of State Banking Powers*, 26 LOY. U. CHI. L. J. 351, 356 n.28 (1995); *Bank of Am., N.A. v. Sorrell*, 248 F. Supp. 1196, 1199 (N.D. Ga. 2002); *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 260 (1995).

<sup>54</sup> BARR ET AL., *supra* note 23, at 173.

<sup>55</sup> Johnson, *supra* note 53, at 357. See, e.g., N.Y. BANKING LAW § 96(1) (granting New York-chartered banks the power to “discount, purchase and negotiate promissory notes, drafts, bills of exchange, other evidences of debt, and obligations in writing to pay in installments or otherwise all or part of the price of personal property or that of the performance of services; purchase accounts receivable . . . ; lend money on real or personal security; borrow money and secure such borrowings by pledging assets; buy and sell exchange, coin and bullion; and receive deposits of moneys, securities or other personal property upon such terms as the bank or trust company shall prescribe; and exercise all such incidental powers as shall be necessary to carry on the business of banking.”).



## 20th Century Developments: The Federal Reserve, the Federal Deposit Insurance Corporation, and the Convergence of Federal and State Regulation

While the OCC and state banking authorities figure prominently in the dual banking system, the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) also play important roles in the bank regulatory regime. Congress created the Federal Reserve in 1913 in response to a 1907 banking panic that highlighted the need for a “lender of last resort” to replenish banks’ reserves when they experience liquidity shortfalls.<sup>56</sup> Today, the Federal Reserve also conducts the nation’s monetary policy, manages certain elements of the country’s payment systems, and regulates bank holding companies, financial market utilities, and banks that join the Federal Reserve System (FRS).<sup>57</sup> The Federal Reserve Act requires all national banks to join the FRS and gives state banks the option of joining.<sup>58</sup> The Federal Reserve accordingly serves as the principal federal regulator of state-chartered banks that become members of the FRS.<sup>59</sup>

The FDIC serves as the principal federal regulator of state-chartered banks that do not join the FRS.<sup>60</sup> Congress created the FDIC in 1933 after a wave of bank failures generated a self-reinforcing cycle of “contagion,” leading depositors to “run” from other banks and cause additional failures.<sup>61</sup> In order to minimize the risk of these types of bank runs, the FDIC insures deposits at regulated institutions up to certain limits and regulates those institutions to ensure their safety and soundness.<sup>62</sup> Because federal law requires national banks to obtain FDIC insurance and all states impose that same requirement on the banks they charter, the FDIC plays a key role in regulating the banking system.<sup>63</sup>

This complex regulatory architecture has resulted in “symbiotic system” with both state regulation of national banks and federal regulation of state banks.<sup>64</sup> In the modern dual banking system, national banks are not wholly immune from generally applicable state laws, and state banks are not wholly immune from generally applicable federal laws. The Supreme Court has explained that “general state laws” concerning “the dealings and contracts of national banks” are valid as long as they do not “expressly conflict” with federal law, “frustrate the purpose for which national banks were created,” or impair the ability of national banks to “discharge the duties imposed upon them” by federal law.<sup>65</sup> National banks are accordingly “governed in their daily course of business far more by the laws of the State than of the nation” because their contracts, ability to acquire and transfer property, rights to collect debts, and liability to be sued for debts

<sup>56</sup> THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, FED. RES. BD. OF GOV. 64 (10th ed. 2016), [https://www.federalreserve.gov/aboutthefed/files/pf\\_complete.pdf](https://www.federalreserve.gov/aboutthefed/files/pf_complete.pdf).

<sup>57</sup> *Id.* at 47, 74-78, 120.

<sup>58</sup> 12 U.S.C. § 321. Membership in the FRS arguably confers reputational benefits on state-chartered banks. *See Federal Reserve Membership*, FED. RES. BANK OF RICHMOND, [https://www.richmondfed.org/banking/federal\\_reserve\\_membership](https://www.richmondfed.org/banking/federal_reserve_membership) (last visited Jan. 17, 2018) (“Membership [in the Federal Reserve System] conveys an association with the general reputation and public trust the Federal Reserve enjoys as our nation’s central bank.”).

<sup>59</sup> THE FEDERAL RESERVE SYSTEM, *supra* note 56, at 77.

<sup>60</sup> *See* SUPERVISION PROGRAM, FED. DEPOSIT INS. CORP. (last visited May 6, 2019), <https://www.fdic.gov/about/strategic/strategic/supervision.html>.

<sup>61</sup> *Id.*

<sup>62</sup> BARR ET AL., *supra* note 23, at 51-52.

<sup>63</sup> *See* SUPERVISION PROGRAM, *supra* note 60.

<sup>64</sup> Robert F. Roach, *Bank Mergers and the Antitrust Laws: The Case for Dual State and Federal Enforcement*, 36 WM. & MARY L. REV. 95, 119 (1994).

<sup>65</sup> *McClellan v. Chipman*, 164 U.S. 347, 357 (1896).

“are all based on State law.”<sup>66</sup> The OCC has attempted to synthesize the relevant case law as establishing a general principle that state regulations of national banks are valid as long as they “do not regulate the manner, content or extent of the activities authorized for national banks under federal law, but rather establish the legal infrastructure around the conduct of that business.”<sup>67</sup> Similarly, state-chartered banks are not wholly immune from federal law. Rather, state banks are subject to certain federal consumer protection,<sup>68</sup> tax,<sup>69</sup> and antidiscrimination laws,<sup>70</sup> in addition to a range of Federal Reserve and FDIC regulations.

A number of other legal developments have caused the regulatory treatment of national banks and state banks to converge. Beginning in the 1960s, many states passed so-called “wild card” statutes granting their banks the power to engage in any activities permitted for national banks.<sup>71</sup> Statutes extending the powers of the Federal Reserve and the FDIC have also ensured competitive equality in the opposite direction. In 1980, Congress enacted legislation requiring all state-chartered banks—including those that do not join the FRS—to abide by reserve requirements set by the Federal Reserve, eliminating the competitive advantage conferred by lower state-law reserve requirements.<sup>72</sup> Similarly, in 1991, Congress enacted legislation prohibiting FDIC-insured state banks from engaging as a principal in activities that are not permitted for national banks absent permission from the FDIC.<sup>73</sup> Because all states require the banks they charter to obtain FDIC insurance, the legislation “had the ultimate effect of unifying the state and the federal banking systems.”<sup>74</sup>

Finally, some federal statutes either explicitly or implicitly preempt state laws in ways that eliminate unequal regulatory treatment for national and state banks. In *Marquette National Bank of Minneapolis v. First Omaha Services Corporation*, the Supreme Court held that the NBA grants national banks the power to “export” the maximum interest rates allowed by their “home” states, even when lending to borrowers in other states with stricter usury laws.<sup>75</sup> In that decision, the Court considered whether a national bank headquartered in Nebraska—which permitted banks to charge credit-card holders up to 18 percent interest per year on certain unpaid balances—could charge its Minnesota customers more than the 12 percent maximum interest allowable under Minnesota law.<sup>76</sup> Specifically, the Court evaluated whether an NBA provision allowing national banks to charge interest rates allowed by the states “where the bank[s] [are] located” applies even when national banks extend credit to customers in other states with stricter usury laws.<sup>77</sup> The Court held that the NBA provision indeed afforded national banks this power, concluding that the national bank was permitted to charge the maximum interest rate allowable under Nebraska law

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<sup>66</sup> *Nat'l Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869).

<sup>67</sup> *National Banks and the Dual Banking System*, OFFICE OF THE COMPTROLLER OF THE CURRENCY at 27 (Sept. 2003), <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/national-banks-and-the-dual-banking-system.pdf>.

<sup>68</sup> *See, e.g.*, 15 U.S.C. § 1601.

<sup>69</sup> *See Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533 (1869).

<sup>70</sup> *See, e.g.*, 42 U.S.C. § 3601.

<sup>71</sup> *See Johnson*, *supra* note 53, at 368.

<sup>72</sup> BARR ET AL., *supra* note 23, at 180.

<sup>73</sup> 12 U.S.C. § 1831a.

<sup>74</sup> Carl Felsenfeld & Genci Bilali, *Is There a Dual Banking System?*, 2 J. BUS. ENTREPRENEURSHIP L. ISS. 1, 73 (2008).

<sup>75</sup> 439 U.S. 299, 301 (1978).

<sup>76</sup> *Id.* at 303.

<sup>77</sup> 12 U.S.C. § 85.

even when lending to Minnesota customers.<sup>78</sup> Two years after the *Marquette* decision, Congress enacted legislation to extend the same power to federally insured state banks, preempting contrary state law and equalizing the regulatory treatment of national and state banks vis-à-vis “interest rate exportation.”<sup>79</sup>

## ***Barnett Bank* and the Powers of National Banks**

While the regulatory treatment of national and state banks has accordingly converged, federal preemption nevertheless confers certain unique benefits on national banks. Under the Supreme Court’s decision in *Barnett Bank of Marion County, N.A. v. Nelson*, federal laws that grant national banks the power to engage in specific activities impliedly preempt state laws that “significantly interfere” with the ability of national banks to engage in those activities.<sup>80</sup> In *Barnett Bank*, the Court held that a federal law granting national banks the authority to sell insurance impliedly preempted a state law that prohibited banks from selling insurance, subject to certain exceptions.<sup>81</sup> In reaching this conclusion, the Court explained that the state law posed an obstacle to the federal statute’s purpose of granting national banks the authority to sell insurance “whether or not a State grants . . . similar approval.”<sup>82</sup> The Court inferred this purpose from the principle that “normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.”<sup>83</sup>

Lower courts have followed *Barnett Bank*’s rule that absent indications to the contrary, federal statutes and regulations that grant national banks the power to engage in specific activities preempt state laws that prohibit or “significantly interfere” with those activities. In *Wells Fargo Bank of Texas N.A. v. James*, for example, the Fifth Circuit held that an OCC rule granting national banks the power to “charge [their] customers non-interest charges and fees” preempted a state statute prohibiting banks from charging a fee for cashing checks in certain circumstances.<sup>84</sup> Similarly, in *Monroe Retail, Inc. v. RBS Citizens, N.A.*, the Sixth Circuit held that this rule preempted state law conversion claims brought against a class of national banks based on fees they charged for processing garnishment orders.<sup>85</sup> Specifically, the Sixth Circuit reasoned that under *Barnett Bank*, “the level of ‘interference’ that gives rise to preemption under the NBA is not very high,” and that the relevant conversion claims “significantly interfere[d]” with national banks’ ability to collect fees.<sup>86</sup> Finally, the Ninth Circuit employed similar reasoning in *Rose v. Chase Bank USA, N.A.*, where it held that an NBA provision granting national banks the power to “loan money on personal security” preempted a state statute imposing various disclosure

<sup>78</sup> *Marquette Nat’l Bank of Minneapolis*, 439 U.S. at 308-09.

<sup>79</sup> 12 U.S.C. § 1831d(a) (“In order to prevent discrimination against State-chartered insured depository institutions . . . with respect to interest rates . . . such State bank[s] . . . may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest . . . at the rate allowed by the laws of the State . . . where the bank is located . . .”).

<sup>80</sup> 517 U.S. 25, 33 (1996).

<sup>81</sup> *Id.* at 28-29.

<sup>82</sup> *Id.* at 31, 37 (internal quotation marks and citation omitted).

<sup>83</sup> *Id.* at 33.

<sup>84</sup> 321 F.3d 488, 495 (5th Cir. 2003). For purposes of brevity, references to a particular circuit in the body of this report (e.g., the Fifth Circuit) refer to the U.S. Court of Appeals for that circuit.

<sup>85</sup> 589 F.3d 274, 281 (6th Cir. 2009).

<sup>86</sup> *Id.* at 283.

requirements on credit card issuers.<sup>87</sup> In arriving at this conclusion, the Ninth Circuit reasoned that “[w]here . . . Congress has explicitly granted a power to a national bank without any indication that Congress intended for that power to be subject to local restriction, Congress is presumed to have intended to preempt state laws.”<sup>88</sup>

Federal courts have also adopted broad interpretations of an NBA provision authorizing national banks to dismiss officers “at pleasure.”<sup>89</sup> In *Schweikert v. Bank of America, N.A.*, the Fourth Circuit held that this provision preempted a state law claim for wrongful discharge brought by a former officer of a national bank.<sup>90</sup> Similarly, the Ninth Circuit has held that this provision preempted a claim brought by a former officer of a national bank for breach of an employment agreement, reasoning that “[a]n agreement which attempts to circumvent the complete discretion of a national bank’s board of directors to terminate an officer at will is void as against [federal] public policy.”<sup>91</sup> Finally, in *Wiersum v. U.S. Bank, N.A.*, the Eleventh Circuit relied on *Barnett Bank* and the Fourth Circuit’s reasoning in *Schweikert* to conclude that this “at pleasure” provision preempted a wrongful-termination claim brought by a former officer of a national bank under a state whistleblower statute.<sup>92</sup>

While federal courts have accordingly adopted expansive views of the circumstances in which state laws “significantly interfere” with national banks’ powers, they have also recognized certain general limits on the preemptive scope of federal banking statutes and regulations. In *Gutierrez v. Wells Fargo Bank, NA*, for example, the Ninth Circuit held that federal banking regulations did not preempt a generally applicable state law prohibiting certain types of fraud.<sup>93</sup> The *Gutierrez* litigation involved a national bank’s use of a bookkeeping method known as “high-to-low” posting for debit-card transactions, whereby the bank posted large transactions to customers’ accounts before small transactions.<sup>94</sup> In *Gutierrez*, customers of the bank brought a variety of state law claims based on the theory that the bank adopted high-to-low posting for the sole purpose of maximizing the overdraft fees it could charge customers.<sup>95</sup> In response, the bank argued that OCC regulations preempted the state law claims.<sup>96</sup>

The Ninth Circuit held that the OCC regulations preempted some, but not all, of the customers’ claims. Specifically, the court held that an OCC regulation authorizing national banks to establish the method of calculating noninterest charges and fees “in [their] discretion” preempted claims premised on the theory that high-to-low posting was an unfair business practice.<sup>97</sup> The court also held an OCC regulation providing that national banks may exercise their deposit-taking powers “without regard to state law limitations concerning . . . disclosure requirements” preempted the customers’ claims that the bank failed to affirmatively disclose its use of high-to-low posting.<sup>98</sup> However, the court held that federal law did not preempt claims that the bank *defrauded* its

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<sup>87</sup> 513 F.3d 1032, 1037 (9th Cir. 2008).

<sup>88</sup> *Id.*

<sup>89</sup> 12 U.S.C. § 24.

<sup>90</sup> 521 F.3d 285, 288-89 (4th Cir. 2008).

<sup>91</sup> *Mackey v. Pioneer Nat’l Bank*, 867 F.2d 520, 524 (9th Cir. 1989).

<sup>92</sup> 785 F.3d 483, 490-91 (11th Cir. 2015).

<sup>93</sup> 704 F.3d 712, 725-28 (9th Cir. 2012).

<sup>94</sup> *Id.* at 716.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 723-28.

<sup>97</sup> *Id.* at 725.

<sup>98</sup> *Id.* at 726.

customers by making misleading statements about its posting method.<sup>99</sup> Specifically, the court reasoned that these claims survived preemption because they were based on “a non-discriminating state law of general applicability that does not conflict with federal law, frustrate the purposes of the [NBA], or impair the efficiency of national banks to discharge their duties.”<sup>100</sup> In reaching this conclusion, the court rejected the argument that federal law preempted the customers’ fraud claims because those claims “necessarily touche[d] on” national banks’ authority to provide checking accounts.<sup>101</sup> The court rejected this argument on the grounds that such an expansive preemption standard “would swallow all laws.”<sup>102</sup> The Ninth Circuit accordingly allowed the customers’ fraud claims to proceed because they did not “significantly interfere” with national banks’ ability to offer checking accounts.<sup>103</sup>

## Watters, Cuomo, and Visitorial Powers over National Banks

While the implications of *Barnett Bank* have been fleshed out most thoroughly in the lower federal courts, the Supreme Court has also applied that decision’s reasoning in two cases concerning an NBA provision prohibiting states from exercising “visitorial powers” over national banks.<sup>104</sup> In *Watters v. Wachovia Bank, N.A.*, the Court held that this provision—together with an OCC regulation providing that national banks may conduct authorized activities through operating subsidiaries—preempted state licensing, reporting, and visitation requirements for the operating subsidiaries of national banks.<sup>105</sup> Specifically, the Court reasoned that the proper inquiry in analyzing whether state law interferes with federally permitted bank activities “focuse[s] on the exercise of a national bank’s powers, not on its corporate structure.”<sup>106</sup> The Court accordingly concluded that the operating subsidiaries of national banks should be treated “as equivalent to national banks with respect to powers exercised under federal law.”<sup>107</sup> And because “duplicative state examination, supervision, and regulation would significantly burden” national banks’ ability to engage in authorized activities, the Court held that those same regulatory burdens also unacceptably interfere with the ability of national bank *subsidiaries* to engage in those activities.<sup>108</sup> However, as discussed later in this report, Congress has abrogated

<sup>99</sup> *Id.* (internal quotation marks omitted).

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 727.

<sup>102</sup> *Id.* (internal quotation marks and citation omitted).

<sup>103</sup> *Id.*

<sup>104</sup> 12 U.S.C. § 484(a). The term “visitorial powers” is derived from the sovereign’s right to inspect the books and records of corporations, which paralleled the right of the church to supervise its institutions and the right of the founder of a charitable institution “to see that [his] property [was] rightly employed.” *Cuomo v. Clearing House Ass’n, LLC*, 557 U.S. 519, 525 (2009) (quoting 1 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 469 (1765)). When the NBA was enacted in 1864, “visitation” was similarly understood as “[t]he act of examining into the affairs of a corporation” by “the government itself.” *Id.* at 526 (quoting 2 J. BOUVIER, A LAW DICTIONARY 790 (15th ed. 1883)).

<sup>105</sup> 550 U.S. 1, 7 (2007).

<sup>106</sup> *Id.* at 18.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

*Watters*'s holding that states may not examine or regulate the activities of national bank subsidiaries.<sup>109</sup>

While the Court adopted a broad view of preemption in *Watters*, it cabined the preemptive effect of the relevant NBA provision two years later in *Cuomo v. Clearing House Association, LLC*.<sup>110</sup> In that decision, the Court held that this NBA provision did not preempt an information request that the New York Attorney General (NYAG) sent to several national banks.<sup>111</sup> Specifically, the NYAG had sent letters to several national banks requesting nonpublic information about their lending practices in order to determine whether the banks had violated state fair lending laws.<sup>112</sup> In response, a banking trade group and the OCC argued that the relevant NBA provision— together with an OCC regulation interpreting that provision to mean that “[s]tate officials may not . . . prosecut[e] enforcement actions” against national banks, “except in limited circumstances authorized by federal law”—preempted the information request.<sup>113</sup>

The Supreme Court rejected this interpretation of the NBA’s visitorial powers provision, drawing a distinction between (1) “supervision,” or “the right to oversee corporate affairs,” which qualify as “visitorial powers,” and (2) “law enforcement.”<sup>114</sup> Because the Court concluded that the NYAG had issued the information requests in his “law enforcement” capacity—as opposed to “acting in the role of sovereign-as-supervisor”—it held that the NBA did not preempt the requests.<sup>115</sup>

## The OCC’s Preemption Rules

As the above discussion makes clear, OCC regulations have figured prominently in litigation over the preemptive scope of federal banking law. While some commentators have contended that the NBA’s text and legislature history implicitly provides the OCC with the authority to promulgate preemption rules,<sup>116</sup> Congress formally recognized that the OCC has such authority in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act).<sup>117</sup> Specifically, Section 114 of the Riegle-Neal Act provides that “[b]efore issuing any opinion letter or interpretive rule . . . that concludes that Federal law preempts the application to a national bank of any State law” concerning certain specified subjects, the OCC must give the public notice and an opportunity submit written comments.<sup>118</sup>

<sup>109</sup> See 12 U.S.C. § 25b(h)(2).

<sup>110</sup> 557 U.S. 519, 536 (2009).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 522.

<sup>113</sup> *Id.* at 524-25.

<sup>114</sup> *Id.* at 527-28.

<sup>115</sup> *Id.* at 535-36. In *Cuomo*, the Court ultimately held that the legality of the NYAG’s information requests depended on the legality of the action that the NYAG threatened to take if the requests were not honored. *Id.* at 536. Because the Court concluded that the NYAG had the legal authority to prosecute judicial enforcement actions against national banks, it vacated the lower court injunction against the requests insofar as the injunction prohibited the NYAG from bringing judicial enforcement actions if the information requests were not honored. *Id.* However, because all parties conceded that the issuance of executive subpoenas (that is, subpoenas issued by an executive branch agency or official, as opposed to a court) to national banks would qualify as an “exercise of supervisory power” that was preempted by the NBA, the Court upheld the injunction as applied to the threatened issuance of executive subpoenas. *Id.*

<sup>116</sup> See Nancy L. Perkins, Howard N. Cayne, & Laurence Hutt, *Watters v. Wachovia: A Functional Approach to Federal Banking Law Preemption*, 27 REV. BANKING & FIN. L. 127, 176-77 (2007).

<sup>117</sup> Pub. L. No. 103-328, 108 Stat. 2366 (1994).

<sup>118</sup> 12 U.S.C. § 43(a).

In the 1990s and early 2000s, the OCC exercised this authority in a number of interpretive letters and legal opinions. In these documents, the OCC took the position that federal law preempted state laws that limited the ability of national banks to:

- advertise;<sup>119</sup>
- operate offices within a certain distance from state-chartered bank home offices;<sup>120</sup>
- operate ATM machines;<sup>121</sup>
- engage in fiduciary activities;<sup>122</sup>
- finance automobile purchases;<sup>123</sup>
- sell annuities;<sup>124</sup>
- sell repossessed automobiles without an automobile dealer license;<sup>125</sup> and
- conduct Internet auctions of certificates of deposit.<sup>126</sup>

## The OCC's 2004 Preemption Rules

In 2004, the OCC expanded upon these interpretive letters and legal opinions by issuing what one commentator has described as “sweeping” preemption rules.<sup>127</sup> The OCC’s 2004 preemption rules articulated a general preemption standard according to which “state laws that obstruct, impair, or condition a national bank’s ability to fully exercise” its federally authorized powers “are not applicable to national banks” except “where made applicable by Federal law.”<sup>128</sup> This general standard accordingly expanded on *Barnett Bank*’s “significant interference” test in two ways. First, the OCC’s 2004 standard omitted the intensifying phrase “significantly” from the *Barnett Bank* test. Second, the 2004 standard by its terms required that national banks be able to “fully” exercise their authorized powers—a phrase that does not appear in *Barnett Bank*. However, despite these facial differences with the *Barnett Bank* test, the OCC explained that it intended the phrase “obstruct, impair, or condition” to function “as the distillation of the various preemption constructs articulated by the Supreme Court, as recognized in *Hines [v. Davidowitz]* and *Barnett Bank*, and not as a replacement construct that is in any way inconsistent with those standards.”<sup>129</sup>

Beyond this general preemption standard, the OCC’s 2004 rules concluded that the NBA preempted certain categories of state laws. First, the rules provided that national banks “may make *real estate* loans . . . without regard to state law limitations concerning”:

<sup>119</sup> OCC Interp. Ltr. No. 804 (Sept. 30, 1997).

<sup>120</sup> OCC Interp. Ltr. No. 590 (June 18, 1992).

<sup>121</sup> OCC Interp. Ltr. No. 939 (Oct. 15, 2001); OCC Interp. Ltr. No. 789 (June 27, 1997).

<sup>122</sup> OCC Corp. Decision 97-33 (June 1, 1997).

<sup>123</sup> Preemption Determination, 66 Fed. Reg. 28,593 (May 23, 2001).

<sup>124</sup> OCC Interp. Ltr. No. 749 (Sept. 13, 1996).

<sup>125</sup> Preemption Opinion, 66 Fed. Reg. 23,977 (May 10, 2001).

<sup>126</sup> Preemption Determination, 65 Fed. Reg. 15,037 (Mar. 20, 2000).

<sup>127</sup> Arthur E. Wilmarth, *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, 233 (2004). See also Hills, *supra* note 3, at 1275 (describing the 2004 OCC preemption rules as “broadly constru[ing] the preemptive effects of federal banking laws.”); BARR, *supra* note 23, at 599 (describing the 2004 OCC preemption rules as “broad”).

<sup>128</sup> 12 C.F.R. §§ 34.4(a); 7.4007(b)(1); 7.4008(d)(1); 7.4009(b) (2005).

<sup>129</sup> Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004).

- licensing and registration (except for purposes of service of process);
- “[t]he ability of a creditor to require or obtain private mortgage insurance, insurance for other collateral, or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices”;
- loan-to-value ratios;
- terms of credit;
- “[t]he aggregate amount of funds that may be loaned upon the security of real estate”;
- escrow accounts;
- security property;
- access to and use of credit reports;
- disclosure and advertising;
- processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;
- disbursements and repayments;
- rates of interest on loans;
- due-on-sale clauses, with certain exceptions; and
- “[c]ovenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan.”<sup>130</sup>

Second, the rules provided that national banks “may make *non-real estate* loans without regard to state law limitations concerning” many of the same matters identified in the regulation concerning real estate lending.<sup>131</sup> Finally, the rules provided that national banks “may exercise [their] *deposit-taking* powers without regard to state law limitations concerning”: (1) abandoned and dormant accounts, (2) checking accounts, (3) disclosure requirements, (3) funds availability, (4) savings account orders of withdrawal, (5) state licensing or registration requirements (except for purposes of service of process), and (6) special purpose savings services.<sup>132</sup>

The OCC’s 2004 rules also identified general categories of state law that the agency interpreted as surviving preemption. Specifically, the rules provided that the NBA does *not* preempt state laws that are consistent with federal law and involve (1) contracts, (2) torts, (3) criminal law, (4) rights to collect debts, (5) the acquisition and transfer of property, (5) taxation, (6) zoning, and, with respect to real estate lending, (7) certain homestead laws.<sup>133</sup> According to the OCC’s 2004 rules, such laws survive preemption so long as they “do not regulate the manner, content or extent of the activities authorized for national banks under federal law.”<sup>134</sup>

<sup>130</sup> 12 C.F.R. § 34.4(a) (2005) (emphasis added).

<sup>131</sup> *Id.* § 7.4008(d)(2) (2005) (emphasis added).

<sup>132</sup> *Id.* § 7.4007(b) (2005) (emphasis added). The “deposit-taking powers” of national banks include the power to “receive deposits and engage in any activity incidental to receiving deposits, including issuing evidence of accounts, subject to such terms, conditions, and limitations prescribed by the Comptroller of the Currency and any other applicable Federal law.” *Id.* § 7.4007(a) (2005).

<sup>133</sup> *Id.* §§ 34.4(b) 7.4007(c), 7.4008(e), 7.4009(c)(2) (2005).

<sup>134</sup> *National Banks and the Dual Banking System*, OFFICE OF THE COMPTROLLER OF THE CURRENCY 27 (Sept. 2003), <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/national-banks-and-the-dual-banking-system.pdf>.



## Section 1044 of Dodd-Frank

The OCC's 2004 preemption rules proved controversial. In 2008, the United States experienced a financial crisis caused in part by reckless subprime mortgage lending and a collapse in the real estate market.<sup>135</sup> In the wake of the crisis, commentators debated the role that federal preemption of state predatory lending laws played in generating the pre-2008 housing bubble. Some commentators contended that national banks played a significant role in the predatory lending that preceded the crisis, and that federal preemption “effectively gut[ted] states’ ability to legislate against predatory lending practices.”<sup>136</sup> By contrast, others rejected the contention that preemption played a significant role in causing the crisis, arguing that national banks and their subsidiaries accounted for only a small share of subprime mortgage lending.<sup>137</sup>

In 2010, Congress responded to concerns over federal preemption of state consumer protection laws in Section 1044 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).<sup>138</sup> Section 1044 provides that federal law preempts such laws only if:

- (A) application of a State consumer financial law would have a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that State;
- (B) in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in [*Barnett Bank*], the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law; or

<sup>135</sup> See generally FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, U.S. FIN. CRISIS INQUIRY COMMISSION 67-80 (2011).

<sup>136</sup> Nicholas Bagley, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2275 (2004). See also Kathleen C. Engel & Patricia A. McCoy, *Federal Preemption and Consumer Financial Protection: Past and Future*, 3 BANKING & FIN. SERVICES POL’Y REP. 25, 34 (2012) (arguing that federal preemption of state consumer protection laws caused state banks to lobby state regulators for deregulation on the grounds that deregulation was necessary to preserve competitive parity with national banks); Lei Ding et al., THE PREEMPTION EFFECT: THE IMPACT OF FEDERAL PREEMPTION OF STATE ANTI-PREDATORY LENDING LAWS ON THE FORECLOSURE CRISIS 19 (2010), <http://ourfinancialsecurity.org/wp-content/uploads/2010/03/UNC-CCC-Preemption-Effect-Impact-of-Federal-Preemption-on-Foreclosure-Crisis.pdf> (finding that OCC-regulated lenders “increased their share of loans originated with risky characteristics in states with strong [predatory lending laws]” after the OCC issued its 2004 preemption rules, and that “preemption consistently increased the default risk of privately securitized mortgages originated by the OCC lenders” in states with predatory lending laws); Testimony of Ill. Att’y Gen. Lisa Madigan before the Financial Crisis Inquiry Commission, 111th Cong. (Jan. 14, 2010) (citing a study conducted by the National Consumer Law Center concluding that in 2006, “national banks, federal thrifts, and their operating subsidiaries were responsible for 31.5 percent of subprime mortgage loans,” and arguing that “states struggled to make the argument that the predatory practices and products which fueled the oncoming [crisis] were unfair and deceptive, because the federal regulators’ refusal to reform those practices and products served as an implicit endorsement of their legality.”); Arthur E. Wilmarth, Jr., *Comptroller Dugan is Wrong About the Causes of the Financial Crisis and the Scope of Federal Preemption*, 1 LOMBARD STREET NO. 15 (Nov. 9, 2009) (“[F]ederally regulated institutions, including several of the largest national banks, were the primary private-sector catalysts of the current financial crisis.”).

<sup>137</sup> See Raymond Natter & Katie Wechsler, *Dodd-Frank Act and National Bank Preemption: Much Ado About Nothing*, 7 VA. L. & BUS. REV. 301, 329-34 (2012); Remarks by John C. Dugan, Comptroller of the Currency at 7 (July 21, 2010), <https://www.occ.treas.gov/news-issuances/speeches/2010/pub-speech-2010-84a.pdf> (“[T]ruly predatory forms of subprime loans never took root among national banks in part because of the OCC’s early and strong guidance addressing these types of loans. And even non-predatory forms of subprime lending . . . were never dominated by national banks . . . The numbers bear out this statement, . . . which is the strongest proof that the federal preemption that applies to national banks did not create a haven for subprime mortgages.”).

<sup>138</sup> Pub. L. No. 111-203, 124 Stat. 1376 § 1044 (2010).

(C) the State consumer financial law is preempted by a provision of Federal law other than title 62 of the Revised Statutes.<sup>139</sup>

Beyond this general preemption standard, Section 1044 contains a number of other provisions narrowing the OCC's preemption authority. First, Section 1044 provides that courts reviewing OCC preemption determinations should accord those determinations only *Skidmore* deference, under which courts assess an agency's interpretation of a statute "depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision."<sup>140</sup> Before the enactment of Dodd-Frank, certain courts had afforded OCC preemption determinations a more permissive form of deference known as *Chevron* deference,<sup>141</sup> according to which courts defer to agency interpretations as long as they are reasonable.<sup>142</sup> Section 1044 accordingly requires that courts take a less deferential posture toward OCC preemption determinations.

Second, Section 1044 provides that no OCC preemption determination "shall be interpreted or applied so as to invalidate, or otherwise declare inapplicable to a national bank, the provision of the State consumer financial law, unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with the legal standard" established by *Barnett Bank*.<sup>143</sup> This "substantial evidence" standard is often used in cases involving the Administrative Procedure Act, which provides that courts shall hold unlawful an agency's formal rules and other determinations made on the basis of a formal hearing when they are "unsupported by substantial evidence."<sup>144</sup> The Supreme Court has explained that "substantial evidence" entails "more than a mere scintilla" of evidence, and requires "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."<sup>145</sup>

Third, Section 1044 provides that the OCC shall (1) "periodically conduct a review, through public notice and comment, of each determination that a provision of Federal law preempts a State consumer financial law," (2) "conduct such review within the 5-year period after prescribing or otherwise issuing such determination, and at least once during each 5-year period thereafter," and (3) "[a]fter conducting the review of, and inspecting the comments made on, the

<sup>139</sup> 12 U.S.C. § 25b(b)(1).

<sup>140</sup> 12 U.S.C. § 25b(b)(5)(A); *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) ("The weight of [an agency's] judgment in a particular case will depend on the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it the power to persuade, if lacking power to control.").

<sup>141</sup> See *Cuomo v. Clearing House Ass'n LLC*, 557 U.S. 837, 842-44 (2009) (acknowledging the "familiar *Chevron* framework" before analyzing an OCC preemption determination); *Nat. City Bank of Ind. v. Turnbaugh*, 463 F.3d 325, 331-32 (4th Cir. 2006) (applying *Chevron* deference to an OCC preemption determination).

<sup>142</sup> See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984) (holding that courts must defer to an agency's "construction of the statute which it administers" as long as agency regulations are "based on a permissible construction of the statute."). According to one recent empirical study, agency interpretations are "significantly more likely to prevail under *Chevron* deference (77.4%) than *Skidmore* deference (56.0%)." Kent Barnett & Christopher J. Walker, *Chevron in the Circuit Courts*, 116 MICH. L. REV. 1, 6 (2017).

<sup>143</sup> 12 U.S.C. § 25b(c).

<sup>144</sup> 5 U.S.C. § 706(2)(E).

<sup>145</sup> *Richardson v. Perales*, 402 U.S. 389, 401 (1971) (internal quotation marks and citation omitted).

determination, . . . publish a notice in the Federal Register announcing the decision to continue or rescind the determination or a proposal to amend the determination.”<sup>146</sup>

Fourth, Section 1044 provides that the OCC must submit to Congress a report addressing its decision to continue, rescind, or propose an amendment to any preemption determination.<sup>147</sup>

Finally, Section 1044 abrogated the Supreme Court’s decision in *Watters*, providing that “State consumer financial laws” apply to the subsidiaries and affiliates of national banks “to the same extent” that they apply “to any person, corporation, or other entity subject to such State law.”<sup>148</sup>

## The OCC’s 2011 Preemption Rules

After Dodd-Frank’s enactment, commentators debated the meaning of Section 1044’s general preemption standard. As discussed, Section 1044’s preemption standard provides that federal law preempts “State consumer financial laws” that “prevent[] or significantly interfere[]” with the powers of national banks “in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in [*Barnett Bank*].”<sup>149</sup> Some commentators have argued that this language simply codifies the *Barnett Bank* standard and was not intended to significantly modify pre-existing law.<sup>150</sup> However, others have argued that Section 1044 was intended to pare back the OCC’s 2004 preemption rules, which interpreted the NBA as preempting state laws that “obstruct, impair, or condition” the powers of national banks.<sup>151</sup> According to this latter group of commentators, the OCC’s “obstruct, impair, or condition” standard was more expansive than *Barnett Bank*’s “significant interference” test, meaning that a codification of that test *would* modify pre-existing law.

In 2011, the OCC responded to the enactment of Section 1044 by issuing a notice of proposed rulemaking that reaffirmed its pre-Dodd-Frank preemption decisions while deleting the “obstruct, impair, or condition” language from its preemption rules.<sup>152</sup> While the OCC acknowledged that this language “created ambiguities and misunderstandings regarding the preemption standard that it was intended to convey,” it maintained that the specific preemption determinations reflected in its 2004 rules were nevertheless consistent with *Barnett Bank*.<sup>153</sup> The OCC accordingly proposed

<sup>146</sup> 12 U.S.C. § 25b(d)(1).

<sup>147</sup> *Id.* § 25b(d)(2).

<sup>148</sup> *Id.* § 25b(e). *See also* Gordon v. Kohl’s Dep’t Stores, Inc., 172 F. Supp. 3d 840, 864 (E.D. Pa. 2016) (noting that “by the plain language of the statute . . . the Dodd-Frank Act effectively overturned the subsidiary-preemption holding in *Watters*”); OCC Interp. Ltr. No. 1132, 2011 WL 2110224, at 1 (May 12, 2011) (noting that Dodd-Frank “eliminates preemption of state law for national bank subsidiaries, agents, and affiliates.”).

<sup>149</sup> 12 U.S.C. § 25b(b)(1).

<sup>150</sup> *See* Natter & Wechsler, *supra* note 137, at 348 (“[I]t appears clear that the Dodd-Frank Act did not modify the traditional legal standards for determining if state law is preempted, and that the legislation simply codifies the *Barnett Bank* case.”).

<sup>151</sup> *See* Hills, *supra* note 3, at 1238 (“How could such unusually specific statutory admonitions *not* be an effort to trim back on the preemption status quo?”); Jared Elost, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*, 89 N.C. L. REV. 1273, 1299 (2011) (“Dodd-Frank requires significant interference, whereas the OCC’s 2004 formulation merely required obstruction or impairment.”).

<sup>152</sup> Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 30,557, 30,563 (proposed May 26, 2011).

<sup>153</sup> *Id.*

reaffirming the specific preemption determinations in its 2004 rules while removing the “obstruct, impair, or condition” standard.<sup>154</sup>

The OCC’s proposal quickly generated controversy. After the OCC issued the notice, the Treasury Department’s General Counsel wrote a letter to the Comptroller of the Currency arguing that the OCC’s proposed rule was “inconsistent with the plain language of [Dodd-Frank] and its legislative history.”<sup>155</sup> Specifically, the Treasury Department argued that interpreting Section 1044 as making no significant changes to existing preemption law conflicted with “basic canons of statutory construction” and legislative history indicating that the provision was intended to “revise[]” the OCC’s preemption standard.<sup>156</sup> Senator Carl Levin also expressed disagreement with the proposed rules in a letter to the Comptroller, arguing that “[i]f [Congress] had wanted to leave the OCC’s purported federal preemptive powers unchanged, [it] could have engaged in a very simple exercise—do nothing.”<sup>157</sup>

Other Senators expressed support for the OCC’s proposed rules. Senators Tom Carper and Mark Warner criticized the Treasury Department’s letter for “ignor[ing] the clear legislative history indicating that [Section 1044] is intended to codify the *Barnett* case.”<sup>158</sup> In responding to the Treasury Department’s argument that Section 1044 was intended to “revise” the OCC’s preemption standards, Senators Carper and Warner argued that the OCC’s proposed rules *would* effectuate the contemplated revision by removing the potentially troublesome “obstruct, impair, or condition” language from the agency’s 2004 rules.<sup>159</sup>

The OCC ultimately agreed with Senators Carper and Warner. In July 2011, the OCC published a final regulation revising its preemption rules.<sup>160</sup> In the final rule, the OCC concluded that “the Dodd-Frank Act does not create a new, stand-alone ‘prevents or significantly interferes’ preemption standard, but, rather, incorporates the conflict preemption legal standard and the reasoning that supports it in the Supreme Court’s *Barnett* decision.”<sup>161</sup> The OCC’s 2011 rule also deleted the phrase “obstruct, impair, or condition” from the relevant preemption standard, noting that preemption determinations based “exclusively” on that language “would need to be reexamined to ascertain whether the determination is consistent with the *Barnett* conflict preemption analysis.”<sup>162</sup> However, the rule indicated that the OCC had not identified any preemption determinations that in fact relied “exclusively” on the relevant language.<sup>163</sup> The final

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<sup>154</sup> *Id.*

<sup>155</sup> Letter from George W. Madison, Gen. Counsel, Dep’t of the Treasury, to John Walsh, Acting Comptroller of the Currency (June 27, 2011), [http://cdn.americanbanker.com/media/pdfs/TreasuryOCC\\_062811.pdf](http://cdn.americanbanker.com/media/pdfs/TreasuryOCC_062811.pdf).

<sup>156</sup> *Id.*

<sup>157</sup> Letter from Senator Carl Levin to Timothy Geithner, Sec’y of the Treasury and John Walsh, Acting Comptroller of the Currency (July 13, 2011).

<sup>158</sup> Letter from Senators Thomas Carper and Mark Warner to Timothy Geithner, Sec’y of the Treasury (July 8, 2011), [https://www.politico.com/pdf/PPM170\\_treasury\\_preemption\\_letter\\_final.pdf](https://www.politico.com/pdf/PPM170_treasury_preemption_letter_final.pdf).

<sup>159</sup> *Id.*

<sup>160</sup> Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 43,549, 43,555 (July 21, 2011).

<sup>161</sup> *Id.*

<sup>162</sup> *Id.* at 43,556.

<sup>163</sup> *Id.* at 43,556 n.43. It does not appear as though the OCC has identified any such preemption determinations since issuing the 2011 rules.

rule also noted that all *future* OCC preemption determinations would be subject to Section 1044’s requirement concerning “case-by-case” determinations.<sup>164</sup>

Since the enactment of Dodd-Frank, a number of courts have interpreted Section 1044 as codifying the *Barnett Bank* standard.<sup>165</sup> Some courts have accordingly concluded that *Barnett Bank* demarcates the boundaries of the OCC’s 2011 preemption rules, reasoning that those rules do not preempt any state laws that would survive preemption under the *Barnett Bank* test.<sup>166</sup> One court has also addressed the appropriate level of judicial deference towards the OCC’s 2011 preemption determinations. As discussed, Section 1044 provides that courts “shall” assess OCC preemption determinations “depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision”—a standard commonly known as “*Skidmore* deference.”<sup>167</sup> In 2018, the Ninth Circuit concluded that the OCC’s 2011 preemption determinations are “entitled to little, if any, deference” under *Skidmore*.<sup>168</sup> Specifically, the Ninth Circuit reasoned that because the OCC’s 2011 preemption determinations represent the agency’s “articulation of its legal analysis” under *Barnett Bank* (as opposed to being grounded in expert *factual* findings), those determinations would not warrant significant deference even in the absence of Section 1044.<sup>169</sup> Whether other federal circuit courts will follow the Ninth Circuit in affording minimal deference to the OCC’s 2011 preemption rules remains to be seen.

## Current Issues in Banking Preemption

As the debates over Section 1044 of Dodd-Frank make clear, a number of banking preemption issues remain the subject of active debate. This final section of the report discusses three additional current issues involving banking preemption and related federalism questions.

<sup>164</sup> *Id.* at 43,557.

<sup>165</sup> See *Lusnak v. Bank of America, N.A.*, 883 F.3d 1185, 1193 (9th Cir. 2018) (“In Dodd-Frank, Congress underscored that *Barnett Bank* continues to provide the preemption standard; that is, state consumer financial law is preempted *only* if it ‘prevents or significantly interferes with the exercise by the national bank of its powers.’”) (quoting 12 U.S.C. § 25(b)(1)(B)); *Meluzio v. Capital One Bank (USA), N.A.*, 469 B.R. 250, 255 (N.D. W. Va. 2012) (“By codifying the *Barnett Bank* decision, the Dodd-Frank Act directs courts to determine national bank preemption by analyzing whether a state statute is irreconcilably in conflict with the NBA.”); *Baptista v. JP Morgan Chase Bank, N.A.*, 640 F.3d 1194, 1197 (11th Cir. 2011) (“[I]t is clear that under the Dodd-Frank Act, the proper preemption test asks whether there is a significant conflict between the state and federal statutes—that is, the test for conflict preemption.”); *U.S. Bank Nat’l Ass’n v. Schipper*, 812 F. Supp. 2d 963, 969 n.1 (S.D. Iowa 2011) (concluding that “the Dodd-Frank Act did not materially alter the [*Barnett Bank*] standard for preemption”).

<sup>166</sup> See *Meluzio*, 469 B.R. at 256-57 (reasoning that if a state law “survive[s] NBA preemption under the Dodd-Frank Act, it necessarily follows” that it also survives preemption under the OCC’s regulations because “[b]oth the Act and the OCC regulation[s] tie preemption to the *Barnett Bank* standard”); *Cline v. Bank of Am., N.A.*, 823 F. Supp. 2d 387, 399 (S.D. W. Va. 2011) (reasoning that if a state law “does not offend the principles espoused in *Barnett Bank*, it necessarily does not offend” the OCC’s 2011 preemption rules because those rules “tied preemption to the *Barnett Bank* standard”).

<sup>167</sup> 12 U.S.C. § 25(b)(5)(A); *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) (“The weight of [an agency’s] judgment in a particular case will depend on the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it the power to persuade, if lacking power to control.”).

<sup>168</sup> *Lusnak*, 883 F.3d at 1193-94.

<sup>169</sup> *Id.*

## Interest Rate Exportation and Non-Banks

A number of recent judicial decisions have generated debate over the circumstances in which *non-bank* financial companies can benefit from banks' ability to "export" the maximum interest rates of their "home" states. As discussed, the Supreme Court has held that national banks may charge any interest rate allowable under the laws of their home states even when lending to borrowers in other states with stricter usury laws.<sup>170</sup> After this decision, Congress extended the power to export maximum interest rates to federally insured state banks.<sup>171</sup> Recently, courts have grappled with whether this exportation power extends to *non-bank* financial companies and debt collectors that purchase loans originated by federally insured banks. That is, courts have addressed the circumstances in which loans originated by federally insured banks remain subject to the usury laws of the banks' home states even when the loans are (1) made to borrowers in other states with stricter usury laws, and (2) subsequently purchased by non-banks, which do not possess the exportation power when they originate loans themselves.

### *Madden* and the "Valid When Made" Doctrine

A number of courts have concluded that in certain contexts, a loan that is non-usurious when originated remains non-usurious irrespective of the identity of its subsequent purchasers—a principle that some commentators have labeled the "valid when made" doctrine.<sup>172</sup> However, in 2015, the Second Circuit rejected the application of this rule in *Madden v. Midland Funding*, holding that non-bank debt collectors that had purchased debt originated by a national bank could not benefit from the bank's exportation power.<sup>173</sup> In *Madden*, a New York resident brought a putative class action under New York usury law against debt collectors that had purchased her credit card debt from a Delaware-based national bank.<sup>174</sup> In response, the debt collectors argued that federal law preempted the New York usury claims because the credit card debt had been originated by a Delaware-based national bank and was not usurious under Delaware law.<sup>175</sup> The Second Circuit rejected this argument, reasoning that the application of New York usury law to the debt collectors did not "significantly interfere" with the national bank's powers under *Barnett Bank*.<sup>176</sup> Specifically, the court reasoned that because the debt collectors were not national banks and were not acting "on behalf of" a national bank, the New York usury claims did not interfere with the national bank's power to export the maximum interest rates of its home state.<sup>177</sup>

<sup>170</sup> See *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).

<sup>171</sup> 12 U.S.C. § 1821d(a). See also *Greenwood Trust Co. v. Commonwealth of Mass.*, 971 F.2d 818 (1st Cir. 1992).

<sup>172</sup> See *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285, 289 (7th Cir. 2005) (concluding that the assignees of a debt were authorized to charge the same interest rate as the assignors "because the common law puts the assignee in the assignor's shoes, whatever the shoe size"); *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148-49 (5th Cir. 1981) ("The non-usurious character of a note should not change when the note changes hands."); *Strike v. Trans-West Disc. Corp.*, 155 Cal. Rptr. 132, 139 (Cal. Ct. App. 1979) (holding that a non-bank that purchased a loan from a bank was exempt from state usury law because the bank was exempt). But see Adam J. Levitin, "Madden Fix" Bills are a Recipe for Predatory Lending, AM. BANKER (Aug. 28, 2017), <https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending> (arguing that the "valid when made" doctrine has historically referred to a different legal rule according to which a non-usurious transaction is not invalidated by a subsequent, separate usurious transaction).

<sup>173</sup> 786 F.3d 246, 249-53 (2d Cir. 2015).

<sup>174</sup> *Id.* at 247-48.

<sup>175</sup> *Id.* at 250.

<sup>176</sup> *Id.* at 251.

<sup>177</sup> *Id.*

The Second Circuit's decision in *Madden* has generated significant debate. In an amicus brief supporting the debt collectors' petition for re-hearing before the Second Circuit, industry groups argued that the decision threatened to seriously disrupt lending markets.<sup>178</sup> Specifically, these groups argued that the court's decision would "significantly impair" banks' ability to manage their risk by selling loans in secondary credit markets—a result that would ultimately inhibit their capacity to originate loans.<sup>179</sup> Similarly, in an amicus brief submitted to the Supreme Court, the OCC and the Office of the Solicitor General (OSG) argued that the Second Circuit's decision was "incorrect," reasoning that "[a] national bank's federal right to charge interest up to the rate allowed by [the NBA] would be significantly impaired if [a] national bank's assignee could not continue to charge that rate."<sup>180</sup> In response, the plaintiff in *Madden* argued that the Second Circuit's decision is unlikely to significantly affect credit markets.<sup>181</sup> Specifically, the *Madden* plaintiff argued that the court's decision will not disrupt credit markets because non-banks that purchase loans originated by banks retain the right to collect the balances of those loans within applicable state law usury limits.<sup>182</sup>

While the Second Circuit ultimately denied the debt collectors' petition for re-hearing and the Supreme Court denied their petition for a writ of certiorari,<sup>183</sup> the *Madden* decision has attracted congressional interest. The Financial CHOICE Act—comprehensive regulatory reform legislation that passed the House of Representatives in June 2017 but did not become law—would have codified the "valid when made" doctrine and abrogated *Madden*.<sup>184</sup> A more limited bill directed solely at codifying the "valid when made" doctrine (H.R. 3299) also passed the House in February 2018 but did not become law.<sup>185</sup> Echoing the arguments made by industry groups, the bill's sponsor contended that the Second Circuit's decision will harm credit markets and impede financial innovation.<sup>186</sup> By contrast, the bill's critics argued that it would facilitate predatory lending by allowing non-banks to evade state usury laws.<sup>187</sup> These proposals have not been re-introduced in the 116th Congress.

<sup>178</sup> Brief of the Am. Bankers Ass'n, Indep. Cmty. Bankers of Am., Cal. Bankers Ass'n, and Utah Bankers Ass'n as Amici Curiae in Support of the Petition for Rehearing and Rehearing En Banc, *Madden v. Midland Funding, LLC*, No. 14-2131, 2015 WL 4153962 at 7-11 (2d Cir. June 26, 2015).

<sup>179</sup> *Id.* at 9-11, 14-15.

<sup>180</sup> Brief for the United States as Amicus Curiae, *Midland Funding LLC v. Madden*, No. 15-610, 2016 WL 2997343 at 6, 8 (May 24, 2016). While the OCC and OSG argued that the Second Circuit's decision was incorrect, they ultimately contended that the Supreme Court should deny the debt collectors' petition for certiorari because the decision presented a poor vehicle for resolving the relevant legal issues. *See id.* at 13-20.

<sup>181</sup> Brief in Opposition, *Midland Funding, LLC v. Madden*, No. 15-610, 2016 WL 2997343 at 17-18 (Feb. 12, 2016).

<sup>182</sup> *Id.*

<sup>183</sup> *See* *Midland Funding, LLC v. Madden*, No. 15-610, 136 S. Ct. 2505 (June 27, 2016).

<sup>184</sup> H.R. 10, 115th Cong. § 581 (2017).

<sup>185</sup> H.R. 3299, 115th Cong. (2017). A companion Senate bill, S. 1642, was referred to the Senate Committee on Banking, Housing, and Urban Affairs in July 2017. S. 1642, 115th Cong. (2017).

<sup>186</sup> Rachel Witkowski, *Legislation Proposed to Counteract Court Ruling on State Usury Caps*, WALL ST. J. (July 11, 2016), <https://www.wsj.com/articles/legislation-proposed-to-counteract-court-ruling-on-state-usury-caps-1468278817>. *See also* A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: NONBANK FINANCIALS, FINTECH, AND INNOVATION, DEP'T OF THE TREASURY 92-93 (July 2018) (arguing that the Second Circuit's decision in *Madden* could negatively affect "bank/loan intermediary partnerships, debt collection activities, loan securitization activities, and simple loan transfers," and recommending that Congress codify the "valid when made" doctrine "to preserve the functioning of U.S. credit markets") [hereinafter "2018 TREASURY REPORT"].

<sup>187</sup> *See* Levitin, *supra* note 172.

## The “True Lender” Doctrine

In a number of cases involving the scope of the exportation doctrine, non-bank financial companies have played a more active role in the origination process than the debt collectors in *Madden*. Specifically, a number of these cases have involved arrangements in which a non-bank financial company solicits borrowers, directs a partner bank to originate a high-interest loan, and purchases the loan from the bank shortly after origination in order to benefit from the bank’s exportation power.<sup>188</sup> Some courts have held that non-banks employing these so-called “rent-a-charter” schemes are not eligible for federal preemption, reasoning that preemption depends on a transaction’s economic realities rather than its formal characteristics.<sup>189</sup> Specifically, these courts have concluded that non-banks do not assume their partner banks’ exportation power when the economic realities surrounding a transaction indicate that the non-banks are the “true lenders.”<sup>190</sup> According to this “true lender” doctrine, non-banks that have established these types of relationships qualify as the “true lenders” when they possess the “predominant economic interest” in the relevant loans when the loans are originated.<sup>191</sup> In these circumstances, some courts have concluded that the non-banks are not entitled to the benefits of federal preemption.

Like the Second Circuit’s decision in *Madden*, these “true lender” decisions have attracted Congress’s attention. In the 115th Congress, H.R. 4439 would have abrogated this line of decisions by making clear that a loan’s originator is always the “true lender” for purposes of the exportation doctrine.<sup>192</sup> The bill’s supporters argued that the “true lender” decisions threaten to undermine partnerships between banks and FinTech companies<sup>193</sup>—a broad category of businesses offering digital financial products that some commentators have hailed for their innovative potential.<sup>194</sup> The bill’s opponents, by contrast, contended that the legislation would allow non-banks to circumvent state usury laws and questioned the value of bank-FinTech partnerships designed with that purpose in mind.<sup>195</sup> H.R. 4439 was referred to the House

<sup>188</sup> See, e.g., *Consumer Fin. Prot. Bureau v. CashCall, Inc., et al.*, No. CV 15-7522-JFW, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016); *CashCall, Inc. v. Morrissey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 30, 2014); *People ex rel. Spitzer v. Cty. Bank of Rehoboth Beach*, 846 N.Y.S. 2d 436 (App. Div. 2007).

<sup>189</sup> See, e.g., *CashCall, Inc., et al.*, 2016 WL 4820635 at \*6; *Morrissey*, 2014 WL 2404300 at \*5; *Cty. Bank of Rehoboth Beach*, 846 N.Y.S. 2d at 439.

<sup>190</sup> See *CashCall, Inc.*, 2016 WL 4820635 at \*6; *Morrissey*, 2014 WL 2404300 at \*5; *Cty. Bank of Rehoboth Beach*, 846 N.Y.S. 2d at 439.

<sup>191</sup> See *CashCall, Inc.*, 2016 WL 4820635 at \*6; *Morrissey*, 2014 WL 2404300 at \*14; *Cty. Bank of Rehoboth Beach*, 846 N.Y.S. 2d at 439.

<sup>192</sup> H.R. 4439, 115th Cong. (2017).

<sup>193</sup> See 2018 TREASURY REPORT, *supra* note 186, at 93-94 (arguing that the “true lender” decisions have resulted in a “fragmented” and “inefficient” regulatory framework that imposes “significant compliance challenges” on bank-FinTech partnerships). See also Letter from James C. Ballentine, Am. Bankers Ass’n, to Hon. Trey Hollingsworth (May 21, 2018), <https://www.aba.com/Advocacy/LetterstoCongress/Documents/Support-HR4439-052118.pdf>; Letter from Richard Hunt, Pres., Consumer Bankers Ass’n to Hon. Jeb Hensarling (May 21, 2018), <https://www.consumerbankers.com/sites/default/files/CBA%20Support%20letter%20HR%204439.HFSCmarkup.5.21.18.pdf>; Andrew Smith, *Giving the Middle Class Credit: New Bill a Step in Right Direction*, THE HILL (Feb. 24, 2018), <https://thehill.com/opinion/finance/375378-giving-the-middle-class-credit-new-bill-a-step-in-right-direction>.

<sup>194</sup> See generally Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232 (2018).

<sup>195</sup> See Letter from Cynthia Coffman, Colo. Att’y Gen., et al. to Hon. Mitch McConnell, et al. (June 27, 2018), <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2018/07/AG-Madden-letter.pdf>; Letter from John W. Ryan, President and CEO, Conference of State Bank Supervisors to Hon. Trey Hollingsworth (May 18, 2018), <https://www.csbs.org/csbs-opposes-true-lender-bill-hr-4439>; Written Testimony of Adam J. Levitin Before the United States House of Representatives Committee on Financial Services, Subcomm. On Fin. Institutions and Consumer Credit, Examining Opportunities and Challenges in the Financial Tech. (“Fintech”) Marketplace at 8-9 (Jan. 30, 2018),



Committee on Financial Services during the 115th Congress but has not been re-introduced in the 116th Congress.

## Special Purpose National Bank Charters for FinTech Companies

Congress is not alone in considering whether to extend the benefits of federal preemption to FinTech companies. In July 2018, the OCC issued a Policy Statement announcing that it will begin accepting applications for “special purpose national bank charters” (SPNB charters) from FinTech companies that are engaged in “the business of banking” but do not take deposits.<sup>196</sup> In the Policy Statement, the OCC explained that the NBA provides it “broad authority” to grant national bank charters to institutions that engage in the “business of banking”—a category that includes paying checks and lending money.<sup>197</sup> The OCC accordingly concluded that it has the statutory authority to grant national bank charters to FinTech companies that engage in these core banking activities.<sup>198</sup> According to the OCC, SPNB charters will help foster responsible innovation and promote regulatory consistency between FinTech companies and traditional banks.<sup>199</sup> The OCC further explained that it will use its existing chartering standards and procedures to evaluate applications for SPNB charters, and that FinTech companies that receive such charters “will be supervised like similarly situated national banks, including with respect to capital, liquidity, and risk management.”<sup>200</sup> While the OCC touted the ability of SPNB charters to “level the playing field with regulated institutions” without explicitly mentioning federal preemption, commentators have observed that preemption represents “the central benefit” offered by such charters.<sup>201</sup>

The OCC’s decision to accept applications for national bank charters from FinTech companies has generated debate. Critics of the policy have contended that FinTech companies’ interest in such charters “is virtually entirely about avoiding state consumer protection laws,” and that “[f]ederal chartering should not be a move to eviscerate” such laws.<sup>202</sup> State regulators have also filed lawsuits challenging the OCC’s authority to charter non-depository FinTech companies. In the spring of 2017, the Conference of State Bank Supervisors (CSBS) and the New York Department of Financial Services (NYDFS) responded to an early OCC proposal to charter FinTech companies by filing suits in the U.S. District Court for the District of Columbia and the U.S. District Court for the Southern District of New York, respectively.<sup>203</sup> The CSBS and NYDFS

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[https://financialservices.house.gov/uploadedfiles/01.30.2018\\_adam\\_levitin\\_testimony.pdf](https://financialservices.house.gov/uploadedfiles/01.30.2018_adam_levitin_testimony.pdf) [hereinafter “Levitin Testimony”].

<sup>196</sup> OFFICE OF THE COMPTROLLER OF THE CURRENCY, POLICY STATEMENT ON FINANCIAL TECHNOLOGY COMPANIES’ ELIGIBILITY TO APPLY FOR NATIONAL BANK CHARTERS (2018), <https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf>.

<sup>197</sup> *Id.* at 2.

<sup>198</sup> *Id.*

<sup>199</sup> *Id.* at 2.

<sup>200</sup> *Id.* at 3.

<sup>201</sup> *Financial Regulation – National Bank Chartering – OCC Allows FinTech Companies to Apply for National Bank Charters*, 132 HARV. L. REV. 1361, 1361 (2019).

<sup>202</sup> Levitin Testimony, *supra* note 195, at 17. See also *New OCC “Fintech” Charter Could Open the Floodgates to Predatory Lending*, NAT. CONSUMER LAW CTR. (July 31, 2018), <https://www.nclc.org/media-center/new-occ-fintech-charter-could-open-floodgates-to-predatory-lending.html>.

<sup>203</sup> *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, 313 F. Supp. 3d. 285 (D.D.C. 2018); *Vullo v. Office of the Comptroller of the Currency*, 2017 WL 6512245, No. 17-cv-3574 (S.D.N.Y. Dec. 12, 2017).

made substantially similar claims, arguing that (1) the NBA does not give the OCC the authority to charter non-depository institutions, (2) the Administrative Procedure Act requires the OCC to follow notice-and-comment rulemaking procedures before issuing SPNBs, (3) the OCC’s decision was arbitrary and capricious, and (4) the OCC’s decision violated the Tenth Amendment by invading states’ sovereign powers.<sup>204</sup> Both district courts dismissed the lawsuits on jurisdictional grounds, reasoning that the organizations failed to identify any imminent injuries to their members and that the case was not ripe for resolution because the OCC had not issued any SPNBs.<sup>205</sup> However, after the OCC issued its Policy Statement in July 2018, both organizations filed new lawsuits that remain pending.<sup>206</sup>

## Banking and the Marijuana Industry

Policymakers have also turned their attention to how federal law affects traditional banks’ responses to changes in state law—namely, state-level efforts to legalize marijuana. While a number of states have legalized marijuana for medical or recreational use,<sup>207</sup> federal law criminalizes the drug’s sale, distribution, and possession,<sup>208</sup> in addition to the aiding and abetting of such activities.<sup>209</sup> Federal law also criminalizes money laundering, making it unlawful to:

- conduct a financial transaction involving the proceeds of a *specified unlawful activity*—a category that includes the sale or distribution of marijuana—“knowing that the transaction is designed . . . to conceal or disguise the nature, the location, the source, the ownership or the control of the proceeds . . . or to avoid a transaction reporting requirement under State or Federal law”;<sup>210</sup> or
- knowingly engage in a monetary transaction in criminally derived property of a value greater than \$10,000 that is derived from *specified unlawful activity*.<sup>211</sup>

Finally, the Bank Secrecy Act (BSA) and associated regulations require that financial institutions report illegal and suspicious activities to the Financial Crimes Enforcement Network (FinCEN) and maintain programs designed to prevent money laundering.<sup>212</sup> Federal banking regulators have broad powers to discipline banks for violations of these laws. The Federal Reserve regularly

<sup>204</sup> Complaint for Declaratory and Injunctive Relief at ¶¶ 49-62, *Vullo v. Office of the Comptroller of the Currency*, 2017 WL 6512245, No. 17-cv-3574 (S.D.N.Y. May 12, 2017); Complaint for Declaratory and Injunctive Relief at ¶¶ 99-121, *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, No. 17-0763 (D.D.C. April 26, 2017).

<sup>205</sup> *Conference of State Bank Supervisors*, 313 F. Supp. 3d at 296-301; *Vullo*, 2017 WL 6512245 at \*7-10.

<sup>206</sup> Complaint for Declaratory and Injunctive Relief, *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, No. 1:18-cv-02449-DLF (D.D.C. Oct. 25, 2018); Complaint for Declaratory and Injunctive Relief, *Vullo v. Office of the Comptroller of the Currency*, No. 1:18-cv-08377-UA (S.D.N.Y. Sept. 14, 2018).

<sup>207</sup> See Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 CASE W. RES. L. REV. 597, 598 n.2-4 (2015) (collecting state laws legalizing marijuana).

<sup>208</sup> 21 U.S.C. §§ 802(6), 812, 841(a)(1).

<sup>209</sup> 18 U.S.C. § 2.

<sup>210</sup> *Id.* § 1956(a)(1)(B).

<sup>211</sup> *Id.* § 1957(a).

<sup>212</sup> 31 U.S.C. § 5318(g); 31 C.F.R. § 1020.320.

conducts examinations of member banks that include evaluations of BSA compliance,<sup>213</sup> and the FDIC has the authority to terminate a bank’s deposit insurance for violations of law.<sup>214</sup>

Because of marijuana’s status under federal law, many banks have refused to serve marijuana businesses even when those businesses operate in compliance with state law.<sup>215</sup> While some small banks have offered accounts to marijuana businesses, an estimated 70 percent of marijuana businesses remain unbanked.<sup>216</sup> Because of this inability to access the banking system, many marijuana businesses reportedly operate entirely in cash, raising concerns about tax collection and public safety.<sup>217</sup>

These perceived problems have attracted congressional interest. In March 2019, the House Committee on Financial Services approved legislation intended to minimize the legal risks associated with banking the marijuana industry.<sup>218</sup> The proposed bill—H.R. 1595, the SAFE Banking Act of 2019—would create a “safe harbor” under which federal banking regulators could not take various adverse actions against depository institutions for serving marijuana businesses that comply with applicable state laws (“cannabis-related legitimate businesses”).<sup>219</sup> The legislation would also provide that for purposes of federal anti-money laundering law, the proceeds from transactions conducted by cannabis-related legitimate businesses shall not qualify

<sup>213</sup> 12 U.S.C. § 325; 31 C.F.R. § 1010.810(b)(2). The Federal Reserve also has significant authority over the nation’s payment systems, *see* THE FEDERAL RESERVE SYSTEM, *supra* note 56, at 120-151, and has attempted to deny access to its payment systems to state-chartered credit unions that serve marijuana businesses, *see* Fourth Corner Credit Union v. Fed. Res. Bank of Kansas City, 861 F.3d 1052, 1053 (10th Cir. 2017).

<sup>214</sup> 12 U.S.C. § 1818(a)(2). Federal prosecutors and regulators have issued guidance attempting to clarify the application of federal law to financial institutions serving marijuana businesses that comply with state law. In 2013, the Department of Justice issued guidance commonly known as the “Cole Memo” explaining that the Department intended to concentrate its marijuana-related enforcement efforts on certain federal priorities (*e.g.*, preventing the distribution of marijuana to minors) that did not include the prosecution of marijuana-related activities authorized by “strong and effective” state regulatory regimes. Memorandum from James M. Cole, Deputy Att’y Gen. to United States Att’ys, Guidance Regarding Marijuana Enforcement 3 (Aug. 29, 2013). However, Attorney General Jeff Sessions rescinded the Cole Memo in January 2018. *See* Memorandum from Jefferson B. Sessions, III, Att’y Gen., to United States Att’ys, Marijuana Enforcement (Jan. 4, 2018).

Shortly after the issuance of the Cole Memo, FinCEN issued guidance clarifying how banks could fulfill their obligations to report illegal and suspicious activities involving marijuana businesses that comply with state law. *See* FIN-2014-G001, BSA Expectations Regarding Marijuana-Related Businesses, FIN. CRIMES ENFORCEMENT NETWORK (Feb. 14, 2014).

<sup>215</sup> *See* Hill, *supra* note 207, at 600 n.11.

<sup>216</sup> Nick Kovacevich, *The Hidden Costs of The Cannabis Business*, FORBES (Feb. 1, 2019), <https://www.forbes.com/sites/nickkovacevich/2019/02/01/the-hidden-costs-of-the-cannabis-business/#320da3127da3>.

<sup>217</sup> *See* Testimony of Maj. Neill Franklin, Baltimore City & Md. State Police Dep’ts & Exec. Dir. Law Enforcement Action Partnership Before the House Comm. on Fin. Services, Subcomm. On Consumer Prot. and Fin. Inst. (Feb. 13, 2019); Stuart Leavenworth, *When Does Too Much Cash Become a Health Risk? When You Own a Marijuana Shop*, MCCLATCHY (Feb. 7, 2018), <https://www.mcclatchydc.com/news/nation-world/national/article198941964.html>; Tom Angell, *Trump Treasury Secretary Wants Marijuana Money in Banks*, FORBES (Feb. 6, 2018), <https://www.forbes.com/sites/tomangell/2018/02/06/trump-treasury-secretary-wants-marijuana-money-in-banks/#547bcfeb3a53>.

<sup>218</sup> H.R. 1595, 116th Cong. (2019).

<sup>219</sup> *Id.* § 2. Specifically, the legislation would bar federal banking regulators from (1) terminating or limiting an institution’s deposit insurance “solely” because the institution serves cannabis-related legitimate businesses, (2) prohibiting, penalizing, or otherwise discouraging an institution from serving cannabis-related legitimate businesses, (3) recommending, incentivizing, or encouraging an institution not to serve an account holder solely because of the holder’s relationship to a cannabis-related legitimate business, (4) taking any adverse or corrective supervisory action on a loan made to a cannabis-related legitimate business solely because the business is a cannabis-related legitimate business, or (5) prohibiting or penalizing an institution from offering various payment services to cannabis-related legitimate businesses. *Id.*

as the proceeds of unlawful activity “solely because the transaction[s] [were] conducted by a cannabis-related legitimate business.”<sup>220</sup> Finally, H.R. 1595 would require FinCEN to issue guidance concerning the preparation of suspicious activity reports for cannabis-related legitimate businesses that is “consistent with the purpose and intent” of the bill and “does not significantly inhibit the provision of financial services” to cannabis-related legitimate businesses.<sup>221</sup>

Variations on some of the SAFE Banking Act’s provisions have been incorporated into broader marijuana-related legislation. The Responsibly Addressing Marijuana Policy Gap Act of 2019 (S. 421 and H.R. 1119) would eliminate federal criminal penalties for persons who engage in various marijuana-related activities in compliance with state law and create a “safe harbor” from adverse regulatory action for depository institutions that serve marijuana businesses.<sup>222</sup> Another Senate bill—S. 1028, the STATES Act—would provide that the Controlled Substances Act’s (CSA’s) marijuana-related provisions do not apply to persons acting in compliance with state marijuana regulations, subject to certain exceptions.<sup>223</sup> While the bill does not have the type of “safe harbor” for depository institutions in H.R. 1595, S. 421, or H.R. 1119, it contains a “Rule of Construction” clarifying that conduct in compliance with the legislation shall not serve as the basis for federal money laundering charges or criminal forfeiture under the CSA.<sup>224</sup>

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<sup>220</sup> *Id.* § 3.

<sup>221</sup> *Id.* § 6.

<sup>222</sup> S. 421, 116th Cong. §§ 101, 204 (2019); H.R. 1119, 116th Cong. §§ 101, 204 (2019).

<sup>223</sup> S. 1028, 116th Cong. (2019).

<sup>224</sup> *Id.* § 6.