States Lack Enforcement and Investigative Authority Over National Banks

THOMAS J. HALL

In this article, the author analyzes a recent decision by the U.S. Court of Appeals for the Second Circuit rejecting state efforts to enforce compliance by national banks with either state or federal law — a welcome ruling for national banks that otherwise would be subject to compliance enforcement at both the state and federal level.

The New York State Attorney General is barred from enforcing state laws against national banks, even where such state laws are not preempted by federal law, ruled the United States Court of Appeals for the Second Circuit in its recent decision in *Clearing House Ass'n, L.L.C. v. Cuomo*.[1] The Second Circuit's decision explains that, although national banks remain subject to both state and federal laws, only the federal government has authority to enforce those laws against national banks. In addition, this ruling means that national banks are freed from the states' authority to investigate violations of state or federal law.

Thomas J. Hall, a member of the Board of Editors of *The Banking Law Journal*, is co-head of the Commercial Litigation Practice Group of Chadbourne & Parke LLP and is based in its New York office. The author gratefully acknowledges the assistance of associate Megan Klein in the preparation of this article. The author can be reached at thall@chadbourne.com.

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

THE NATIONAL BANK ACT

The activities of national banks are governed by the National Bank Act (the "NBA"), enacted by Congress in 1864. In addition to authorizing the creation of national banks and establishing a uniform national currency secured by United States bonds, the NBA sanctioned their exercise of certain enumerated powers, which included "all such incidental powers as shall be necessary to carry on the business of banking."[2]

The Office of the Comptroller of the Currency (the "OCC") is the federal agency charged with governing national banks. The OCC oversees the execution of laws concerning national banks and promulgates rules and regulations governing their operation. The OCC is also responsible for examining the practices of national banks and, if necessary, taking supervisory action against those that fail to comply with laws or otherwise engage in unsound banking practices.

The United States Supreme Court has often been called upon to interpret the NBA and, in doing so, has emphasized the nature of national banks as agencies of the federal government. Specifically, the Supreme Court has explained that national banks are "instrumentalities of the federal government, created for public purpose, and as such, necessarily subject to the paramount authority of the United States."[3]

BACKGROUND

In 2005, then-New York Attorney General Eliot Spitzer conducted a preliminary investigation into the possible existence of racial discrimination in the real estate lending practices of several national banks with operating subsidiaries in New York State. That preliminary investigation revealed that a significantly higher percentage of high-interest home loans were being issued to African-American and Hispanic borrowers than to white borrowers. Concluding there was *prima facie* evidence of racial discrimination, the New York Attorney General advanced his investigation by issuing "letters of inquiry" to those national banks[4] suspected of racial discrimination. These letters requested that the banks voluntarily produce non-public information relating to their real estate lending practices. The letters noted that such

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

written requests had been issued "in lieu of…a formal subpoena," such that the national banks could expect more formal action if they failed to comply with the Attorney General's request.

In response, both the OCC and The Clearing House Association, L.L.C., a consortium of national banks, filed suit against the Attorney General in the United States District Court for the Southern District of New York claiming that the Attorney General did not have the authority to investigate the national banks' lending practices.[5] The New York Attorney General, in turn, asserted he was authorized to enforce both federal and state anti-discrimination lending laws[6] against national banks.

Central to both cases was whether the Attorney General's actions impinged on the federal government's exclusive visitorial powers over national banks in violation of 12 U.S.C. § 484(A) ("Section 484") and the OCC's implementing regulation codified at 12 C.F.R. § 7.4000. Section 484 provides that "[n]o national bank shall be subject to any visitorial powers," but it provides no definition of the "visitorial powers" that it proscribes.[7] Seeking to clarify its exclusive authority to govern national banks, the OCC implemented 12 C.F.R. § 7.4000 in 1996.[8] The OCC's regulation defines "visitorial powers" and bestows the OCC with exclusive authority to investigate and bring enforcement actions against national banks when they fail to comply with state and federal banking laws.

Characterizing the Attorney General's actions against the national banks as "visitorial" in nature, the OCC and Clearing House argued that the Attorney General's assertion of authority was in direct conflict with, and thus preempted by, Section 484 and 12 C.F.R. § 7.4000. Both the OCC and Clearing House sought permanent injunctions enjoining the New York State Attorney General from demanding inspection of non-public information and from bringing additional enforcement actions against the national banks to enforce state fair lending laws. Additionally, the Attorney General counterclaimed in *Clearing House* that the private right of action provision of the Federal Housing Act ("FHA"),[9] which authorizes lawsuits brought by an "aggrieved person," permitted New York State to bring enforcement actions against national banks in its *parens patriae* capacity.[10]

The district court issued two separate opinions. First, in *OCC v. Spitzer*, it held that the "the Attorney General's assertion of visitorial authority imper-

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

missibly interferes with the OCC's exclusive supervisory role…."[11] In so holding, the court permanently enjoined the Attorney General from demanding inspection of national banks' non-public information and from bringing enforcement actions against the national banks to compel compliance with state investigations or to enforce state fair lending laws. Second, in *Clearing House v. Spitzer*, the court limited its analysis to whether the Attorney General was authorized to sue the national banks in the state's *parens patriae* capacity to enforce the FHA's fair lending provisions. Rejecting the Attorney General's claim, the court held that an action brought in the state's *parens patriae* capacity against the national banks constituted an exercise of visitorial powers prohibited by Section 484. As a result of these two opinions, the Attorney General was enjoined from bringing any action against the national banks under New York state law or the FHA in a *parens patriae* capacity.

The Attorney General appealed both decisions, and the Second Circuit consolidated the cases on appeal. In support of the OCC and Clearing House, the American Bankers Association, the Consumer Banks Association, and the Financial Services Roundtable filed an amicus brief arguing the importance of bestowing the OCC with exclusive authority to enforce any state law affecting the exercise of national banks' lending practices.[12] In support of the New York Attorney General, the National Association of Realtors, and the New York State Association of Realtors, Inc. submitted an amicus brief expressing their interest in combating discriminatory practices in mortgage lending so as to ensure the continued availability of ample funds for mortgage lending.[13] Attorneys General from forty-three other states filed an amicus brief expressing their collective discontent with the OCC's "aggressive attempts to preempt state laws and state enforcement authority as they relate to national banks."[14] Multiple civil rights groups with extensive experience and interest in fair lending enforcement filed an amicus brief contending that the Attorney General's actions were authorized by the standing and fair lending provisions of the FHA.[15] Finally, a group of consumer protection groups filed an amicus brief arguing that state enforcement against national

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

banks was essential to ensuring that national bank subsidiaries comply with fair lending and consumer protection laws.[16]

THE SECOND CIRCUIT'S ANALYSIS

Visitorial Powers

The central issue before the Second Circuit was whether the OCC's interpretation of the term "visitorial powers" as used in Section 484 was entitled to deference such that the New York Attorney General should be prohibited from continuing his actions against the national banks. The complete text of Section 484 reads:

> No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress.[17]

The relevant text of 12 C.F.R. § 7.4000 interprets Section 484 and, in doing so, accomplishes several OCC objectives. First, it defines visitorial powers to include:

(1) examination of national banks,

(2) inspection of a bank's books and records,

(3) regulation and supervision of activities authorized or permitted pursuant to federal banking law, and

(4) enforcing compliance with any applicable federal or state laws concerning those activities.[18]

Second, the OCC's regulation construes Section 484 as granting the OCC with the "exclusive visitorial authority with respect to the content and conduct of activities authorized for national banks under Federal law," unless federal law provides otherwise.[19]

Third, it clarifies Section 484's "courts of justice" exception, explaining

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

that "[t]his exception…does not grant state or other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law…."[20]

The *Chevron* Analysis

In analyzing the OCC's interpretation of "visitorial powers," the court followed the methodology in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,[21] which outlines the framework for reviewing an agency's construction of a statute that the agency administers. Under *Chevron*, the first step is to determine whether Congress has "directly spoken to the precise question at issue."[22] If Congress's intent is made clear by statute, "that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[23] If, however, Congress has not directly addressed the question, such that the statute is silent or ambiguous with respect to the specific issue, the court must next determine whether the agency's interpretation is reasonably based on a permissible construction of the statute.

The Attorney General argued that the *Chevron* framework was not an appropriate method for analyzing the OCC's regulation because, as an intrinsic aspect of state sovereignty, a state's authority to enforce its non-preempted state laws should be afforded a presumption against preemption. The Second Circuit disagreed and noted that national banking is not an area traditionally regulated by the states such that a presumption against preemption should apply. Instead, as the Second Circuit had previously stated in *Wachovia v. Burke*, the presumption against preemption "'disappears' in the context of national bank regulation, which has been 'substantially occupied by federal authority for an extended period of time.'"[24] As such, no presumption against preemption applied to the OCC's regulation, and the court proceeded to analyze the regulation under the *Chevron* framework.

Under the first step of the *Chevron* framework, the court set out to determine whether Congress intended Section 484 to allow states and their representatives to enforce laws such as New York's discrimination-in-lending law against national banks. To facilitate its analysis, the court turned to previous decisions discussing Congress's intent as to the rights of national banks. For example, the Supreme Court first examined the meaning of "visitorial pow-

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

ers" in *Guthrie v. Harkness*, holding that the rights of shareholders to inspect a corporation's books and records did not constitute prohibited visitorial powers under Section 484.[25] Later, in *National State Bank, Elizabeth, N.J. v. Long*, the Third Circuit held that, while the precise scope of visitorial powers is unclear, "they do encompass examination of the bank's books and records," such that a New Jersey state anti-redlining statute requiring state examination of national banks' books and records was barred by Section 484.[26]

Most recently, the Supreme Court analyzed Section 484's prohibition of visitorial powers in *Watters v. Wachovia Bank, N.A*,[27] a decision upon which the majority relied heavily in its opinion. While the main issue in *Watters* was whether a national bank's lending activities were immune to state governance when those activities were conducted through operating subsidiaries, the Second Circuit gave great weight to its analysis of "visitorial powers." In *Watters*, national banks challenged Michigan state statutes on the basis that such statutes granted to state authorities what amounted to "visitorial powers" over their operating subsidiaries. Specifically, those powers included:

(1) requiring banks to register and pay fees to the state before conducting banking activities therein,

(2) requiring production of financial statements to state authorities,

(3) granting state authorities inspection and enforcement authority over banks, and

(4) authorizing state authorities to take regulatory or enforcement actions against banks.[28]

The Supreme Court held that the powers granted under the statute to the Michigan state authorities were "visitorial" in nature and thus prohibited by Section 484. Stating that "real estate lending, when conducted by a national bank, is immune from state visitorial control," the Court upheld the lower court decision holding that the national bank subsidiaries were not subject to the state's real estate lending laws.

In light of the *Watters* decision, it seemed clear to the Second Circuit that the New York Attorney General's proposed actions were "at least in some sense 'visitorial.'"[29] Thus, wrapping up the analysis of the first prong of the

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

Chevron doctrine, the court held that although the "precise scope of 'visitorial' powers is not entirely clear," it was evident that Congress had not expressed a clear intent to permit state officials to enforce state fair lending laws against national banks. Instead, it was clear "that investigative and enforcement powers of the type the Attorney General has sought to exercise here are at least in some sense 'visitorial' whether or not they unambiguously fall within the scope of §484(a)."[30]

Proceeding to step two of the *Chevron* framework, the court sought to determine whether the OCC's regulation was a reasonable construction of Section 484 and, therefore, worthy of deference by the court. Notwithstanding certain inadequacies in the OCC's argument defending its regulation, the court explained that, under *Chevron*, it was bound to uphold the agency's regulation unless it was "arbitrary, capricious, or manifestly contrary to the statute."[31] Especially in light of the *Watters*, the court noted that the OCC's regulation was "not inconsistent with judicial precedent." Additionally, the OCC's regulation was also "consistent with the intent of creating a national banking system that is subject to cohesive, uniform supervision by the primary regulator of national banks."[32] As such, the court concluded that "the OCC reached a permissible accommodation of conflicting policies that were committed to it by the statute" in light of judicial precedent and known Congressional intent.[33]

The court rejected the Attorney General's secondary argument that the state could continue to exercise its visitorial powers over national banks under Section 484's "courts of justice" exception. Stating that "the Attorney General's proposed interpretation of this exception would swallow the rule," the court explained that the "courts of justice" exception pertained only to powers inherent in the judiciary. The court accepted the OCC's interpretation that the "courts of justice" exception served only to retain the inherent authority of the court themselves to take action against national banks.

As such, because Congress had expressed no clear intent to allow state authorities to exercise visitorial powers over national banks, and because the OCC's interpretation of Section 484 was reasonable in light of judicial precedent, the court's *Chevron* analysis led it to conclude that the district court was justified in deferring to the OCC's' interpretation of Section 484.

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

Analysis of the Attorney General's Authority Under the Fair Housing Act

Finally, the court responded to the New York Attorney General's argument that he was permitted to bring an action against the national banks in a *parens patriae* capacity to enforce the FHA. The district court had concluded that an action brought by the Attorney General in his *parens patriae* capacity would constitute a prohibited visitation under federal law. The Second Circuit, however, did not undertake a Section 484 analysis but instead raised *sua sponte* the issue of whether subject matter jurisdiction existed. The court's analysis noted that the Attorney General had not sued to enforce the FHA against the national banks. Additionally, the court noted that Clearing House members were required to follow the fair lending provisions of the FHA regardless of whether the Attorney General had enforcement authority. This analysis led the court to conclude that the FHA claim was moot on the basis that there would be no hardship to the parties of withholding court consideration. As such, the court vacated the injunction against the FHA's enforcement and remanded the case to the district court with instructions to dismiss the claim.

The Dissent

The dissenting opinion concurred with the majority as to the Attorney General's FHA claim, but dissented as to the balance of the majority's decision based, above all, of the belief that the OCC should not be empowered to bar New York State from enforcing its civil rights laws in the real estate lending context. The dissent stated that the OCC's actions constituted a "usurping [of] 'residual power reserved to the states.'"[34] The dissent believed that the New York Attorney General's actions were justified under the state's police power to investigate civil rights violations being committed by entities in New York. Additionally, the dissent contended that nothing in the NBA was intended to preclude state enforcement of nonpreempted state laws, adding that "[i]t is difficult to imagine a more core aspect of state sovereignty than the authority to pass and enforce valid nonpreempted state laws."[35] Not only, the dissent concluded, did the OCC's regulation upset the balance of political accountability between citizens and the federal and state govern-

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

ments, but it gave a federal agency undue power to shape state policy. Finally, the dissent believed that the *Watters* decision did not compel the result reached by the majority because, unlike the Michigan statutes at issue in *Watters*, the New York state laws banning racial discrimination in lending were not expressly preempted by federal law.

CONCLUSION

The Second Circuit's decision represents a sound rejection of efforts by the states to enforce compliance by national banks with either state or federal law. This protection extends to investigations by state officials. In light of the increasing activism of various state attorneys general, this decision is no doubt welcome relief to national banks that otherwise would be subject to compliance enforcement at both the state and federal level.

NOTES

[1] *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[2] 12 U.S.C. § 24 Seventh.

[3] *Easton v. Iowa*, 188 U.S. 220, 238 (1903).

[4] The national banks targeted by the Attorney General's letters of inquiry were Wells Fargo Bank, N.A., HSBC Bank USA, N.A., J.P. Morgan Chase Bank, N.A., and Citibank, N.A.

[5] *Office of the Comptroller of the Currency v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005); *Clearing House Ass'n, L.L.C. v. Spitzer*, 394 F. Supp. 2d 620 (S.D.N.Y. 2005).

[6] Specifically, the Attorney General claimed that he was empowered to enforce provisions of the Equal Credit Opportunity Act and the New York State Executive Law § 296-a. 15 U.S.C. 1691, *et seq.*; N.Y. Exec. Law § 296-a(1)(b).

[7] 12 U.S.C. § 484(A).

[8] 12 C.F.R. 7.4000.

[9] 42 U.S.C. § 3613(a)

[10] An action brought in a *parens patriae* capacity is one where the state brings suit on behalf of its citizens to prevent injury to those who cannot represent themselves.

[11] 396 F. Supp. 2d at 407.

[12] Brief of the American Bankers Ass'n, Consumer Bankers Ass'n, and the Financial

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.

Services Roundtable as Amici Curiae in Support of Appellees and of Affirmance of the Judgment Below, *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[13] Brief of the National Ass'n of Realtors and New York State Ass'n of Realtors, Inc. as Amici Curiae in Support of Appellant and Reversal of the Decision Below, *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[14] Brief Amicus Curiae of State Attorneys General in Support of Appellant, *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[15] Brief in Support of Appeal by Amici Curiae Lawyers' Committee for Civil Rights *et al.*, *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[16] Brief for Amici Curiae Center for Responsible Lending, *et al.*, *Clearing House Ass'n, L.L.C. v. Office of the Comptroller of the Currency*, Nos. 05-996 (L) & 05-6001(CON), 2007 U.S. App. Lexis 27938 (2d Cir. Dec. 4, 2007).

[17] 12 U.S.C. § 484(A).

[18] 12 C.F.R. § 7.4000(a)(2)(i)-(v).

[19] 12 C.F.R. § 7.4000(a)(3).

[20] 12 C.F.R. § 7.4000(b)(2)

[21] 467 U.S. 837, 842-44 (1984).

[22] *Chevron*, 467 U.S. at 842.

[23] *Id.* at 842-43.

[24] *Clearing House*, 2007 U.S. App. Lexis 27938, at *14 (quoting *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305, 314 (2d Cir. 2005))

[25] 199 U.S. 148, 157 (1905).

[26] 630 F.2d 981, 989 (3d Cir. 1980)

[27] 127 S. Ct. 1559 (U.S. 2007).

[28] *Watters*, 127 S. Ct. at 1565-66.

[29] *Clearing House*, 2007 U.S. App. Lexis 27938, at *26.

[30] *Clearing House*, 2007 U.S. App. Lexis 27938, at *26.

[31] *Id.* at *32 (quoting *Chevron*, 467 U.S. at 844).

[32] *Id.* at *34 (citation omitted).

[33] *Id.* at *35.

[34] *Id.* at *57-58 (Cardamone, J., dissenting).

[35] *Id.* at *64.

Published in the March 2008 issue of The Banking Law Journal.
Copyright ALEXeSOLUTIONS, INC.