Preemption Rights of National Bank Operating Subsidiaries: The Fight for Visitorial Power

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I. INTRODUCTION ................................................................. 181

II. BACKGROUND ................................................................. 182
   A. Facts of Wells Fargo v. Boutris ............................................... 182
   B. National Bank Preemption .................................................... 183
   C. Operating Subsidiary Regulations ........................................... 185
      1. Defining Operating Subsidiaries ........................................... 185
      2. Laws Applicable to Operating Subsidiaries ......................... 186
   D. Holding of Wells Fargo ......................................................... 186

III. ANALYSIS ................................................................. 186
   A. Legitimacy of Operating Subsidiaries ....................................... 186
   B. Preemption Rights of Operating Subsidiaries ............................ 190
      1. Validity of Section 7.4006 ................................................... 190
      2. Visitorial Power Over Operating Subsidiaries ...................... 191
   C. State Sovereignty Concerns .................................................. 192
   D. Consumer Protection Concerns ............................................. 195

IV. RECOMMENDATION ......................................................... 196

V. CONCLUSION ................................................................. 197

I. INTRODUCTION

In May 2003, the United States District Court for the Eastern District of California decided Wells Fargo Bank v. Boutris,1 and enjoined the Commissioner of the California Department of Corporations (Commissioner) from asserting visitorial power over an operating subsidiary of a national bank.2 The decision has resulted in a firestorm across the country, causing heated debate among state and federal regulators. Critics of the decision are concerned about possible abuses of consumer protection and infringement on state sovereignty.

The ultimate question decided in Wells Fargo was whether the Commissioner was preempted by a regulation of the Office of the Comptroller of the Currency (OCC)3 from exercising visitorial power over an operating subsidiary of a national bank. Preemptive

1. Wells Fargo Bank v. Boutris, 265 F. Supp. 2d 1162 (E.D. Cal. 2003) (holding operating subsidiaries are subject to state law only to the same extent as their parent national bank).
2. Id. at 1170.
3. The OCC is the administrative agency with the primary responsibility of supervising national banks. The head of the OCC is the Comptroller of the Currency (Comptroller). The current Comptroller is John D. Hawke, Jr.
regulations issued by the OCC have long been a hot topic in the realm of national banks; however, they have just recently come into focus as a topic of concern in the area of operating subsidiaries. The courts have developed many tools to analyze administrative regulations and preemption. However, *Wells Fargo* provided the first chance for a court to consider administrative preemption in the context of operating subsidiaries of national banks.

By using the previously developed tools to analyze the novel issue presented in *Wells Fargo*, this Note will argue that *Wells Fargo* was correctly decided. While many of the conclusions in the case seem unsupported, the holding actually has a strong legal and historical foundation. Part II outlines the facts and holding of *Wells Fargo*. It also provides a brief history of national bank preemption and the OCC’s regulations concerning operating subsidiaries. Part III discusses the validity of the OCC’s operating subsidiary regulations and, furthermore, who has authority to exert visitorial power over those operating subsidiaries. Most importantly, Part III also confronts the aftermath of *Wells Fargo* and argues that the resulting concerns over state sovereignty and consumer protection are unfounded. Part IV offers a suggestion on how to deal with the aftermath of *Wells Fargo*. The Note concludes that *Wells Fargo* was properly decided.

II. BACKGROUND

A. Facts of *Wells Fargo Bank v. Boutris*

In a struggle for visitorial power over an operating subsidiary of a national bank, Wells Fargo Bank, N.A. (Wells Fargo) filed a lawsuit against the Commissioner of the California Department of Corporations. Wells Fargo sought a permanent injunction to enjoin the Commissioner from asserting visitorial power over its operating subsidiary. The OCC, in support of Wells Fargo, filed as amicus curiae in the case. The court decided the issue of whether the Commissioner was preempted by an OCC regulation from exercising visitorial power over an operating subsidiary of a national bank.

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4. See infra Part III.A.


6. 265 F. Supp. 2d 1162 (holding operating subsidiaries are subject to state law only to the same extent as their parent national bank).

7. According to an OCC regulation, visitorial powers include “[e]xamination of a bank; [i]nspection of a bank’s books and records; [r]egulation and supervision of activities authorized or permitted pursuant to federal banking law; and [e]nforcing compliance with any applicable federal or state laws concerning those activities.” 12 C.F.R. § 7.4002(a)(2) (2004).


9. Id. at 1164.

10. The court also decided two other issues. First, the court held that California’s per diem statute was preempted by the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), because it limited the rate of interest that could be charged. Id. at 1175. Second, the court held Wells Fargo was not entitled to relief on its retaliation and 42 U.S.C. §§ 1983 and 1988 claims. Id. at 1179. These issues, however, are not relevant to this Note.
The conflict arose from events surrounding the mortgage lending activities of Wells Fargo Home Mortgage, Inc. (WFHMI), a state-chartered corporation and operating subsidiary owned by Wells Fargo. Under the California Residential Mortgage Lending Act (CRMLA) and the California Finance Lenders Law (CFLL), WFHMI was licensed to perform real estate lending activities. The Commissioner is responsible for enforcing the CRMLA and the CFLL, and pursuant to this power, he “asserted regulatory, supervisory, examination and enforcement authority over WFHMI.” In 2002, the Commissioner “demanded that WFHMI conduct an audit of its residential mortgage loans made in California during 2001 and 2002.” The Commissioner was concerned WFHMI was charging interest in violation of a per diem statute, and he wanted WFHMI to make proper refunds.

WFHMI objected to the audit, claiming that “because it is an operating subsidiary of a national bank it is subject to the OCC’s exclusive regulatory authority.” In its brief, the OCC agreed with this position, stating:

[b]ecause federal law prohibits the [Commissioner] from exercising visitorial powers over a national bank engaged in real estate lending pursuant to federal law, the [Commissioner] may not exercise visitorial power over the national bank conducting that activity through an operating subsidiary licensed by the OCC, absent federal law dictating a contrary result.

The Commissioner conceded that the OCC had exclusive visitorial power over Wells Fargo; however, the Commissioner did not agree that these powers extended to WFHMI. Alternatively, the Commissioner argued that WFHMI, as a general corporation of the state of California, is subject to state regulatory control and that the OCC, by interfering with that control, was violating California’s state sovereignty under the Tenth Amendment. After WFHMI’s objection, the Commissioner “instituted administrative proceedings to revoke WFHMI’s licenses under CRMLA and CFLL . . . .” Wells Fargo and WFHMI unsuccessfully fought the administrative proceeding and as a result WFHMI’s licenses were taken.

B. National Bank Preemption

To decide whether an operating subsidiary of a national bank should gain the same preemption rights as its parent national bank, it is important to understand the principles behind national bank preemption. The Supremacy Clause of the United States Constitution authorizes federal law to preempt state law. In general, state law may be

11. Id. at 1164 (citing Def.’s Statement of Undisputed Facts ¶ 5) [hereinafter Def.’s SUF].
12. Wells Fargo, 265 F. Supp. 2d at 1164 (citing Def.’s SUF ¶ 6).
13. Id. (citing Def.’s SUF ¶ 18).
14. Id. The California per diem statute prohibits charging interest on loaned mortgage funds for a period of more than one day prior to recording the mortgage. Id. at 1172.
15. Id. at 1164 (citing Def.’s SUF ¶ 20).
16. Wells Fargo, 265 F. Supp. 2d at 1169 (citing OCC Amicus Br. at 14).
17. Id. at 1167.
18. Id. at 1170.
19. Id. at 1164.
20. Id.
21. U.S. CONST. art. VI, cl. 2. (“This Constitution, and the Laws of the United States which shall be made
preempted in one of three ways: (1) express language in a federal statute;\(^{22}\) (2) a federal regulatory scheme “so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it”;\(^{23}\) or (3) conflict preemption.\(^{24}\) Additionally, federal regulations have the same preemptive effect as federal statutes.\(^{25}\)

It has been possible to charter a national bank since the landmark case of *McCulloch v. Maryland*.\(^{26}\) Moreover, national banks are recognized as “instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.”\(^{27}\) Subsequently, principles of federal preemption do not permit states, by lawmaking, taxation or otherwise, “to retard, impede, burden, or in any manner control, the operations” of a national entity.\(^{28}\) In fact, the Supreme Court has recognized from a very early point that limits should be placed on states’ ability to regulate national banks.\(^{29}\) To support this conclusion, the National Bank Act was created.\(^{30}\) The Act provides a comprehensive legislative scheme for regulating national banks.\(^{31}\) Furthermore, it is explicitly asserted that the National Bank Act functions “to protect national banks against intrusive regulation by the States.”\(^{32}\)

In the context of visitorial power, the National Bank Act provides a specific

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23. Id. (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)). This is commonly referred to as field preemption.

24. Conflict preemption may result when observance of both laws is a “physical impossibility.” Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963) (holding that a state statute that excluded out-of-state avocados from the state was not preempted by federal law because it was not impossible to comply with both statutes). However, conflict preemption may also occur if the state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” Hines v. Davidowitz, 312 U.S. 52, 67 (1941) (holding that a state may not interfere with a complete federal regulatory scheme for alien registration by enforcing an inconsistent state statute).

25. Fidelity Fed. Sav. and Loan Ass’n v. De la Cuesta, 458 U.S. 141, 153 (1982) (holding that state law was preempted by federal regulations giving Federal Home Loan Bank Board authority to exercise “due-on-sale” clauses in home mortgages).

26. 17 U.S. (4 Wheat.) 316 (1819) (upholding an act to incorporate the Bank of the United States and holding states may not tax the Bank because it would interfere with the act, which is the supreme law of the land).

27. Davis v. Elmira Sav. Bank, 161 U.S. 275, 283 (1896) (holding state statute giving savings banks preference over other creditors of insolvent national bank is preempted by federal law requiring a ratable dividend on money paid on all claims).


29. See id. at 325-30 (holding states may not tax national banks); Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 32-36 (1996) (holding state law is preempted by federal law authorizing national banks to engage in insurance activities).

30. 12 U.S.C. §§ 21 et seq. (1864). The National Bank Act was passed to stabilize the economy after the Civil War; it established a national system of banking and allowed for the chartering of national banks.


32. Bank of America v. City and County of San Francisco, 309 F.3d 551, 561 (9th Cir. 2002) (holding city ordinances preventing federal savings associations and national banks from charging ATM fees to non-depositors are preempted by federal statutes).
regulatory scheme for asserting visitorial power over a national bank, stating: “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 . . . .” While Section 484 does not explicitly grant exclusive visitorial control to the OCC, the OCC and the Court interpret Section 484 as a grant of exclusive visitorial power. Therefore, unless specifically authorized by federal law, states may not regulate, examine or enforce laws against national banks.

C. Operating Subsidiary Regulations

I. Defining Operating Subsidiaries

It is important to understand exactly what constitutes an operating subsidiary of a national bank to decide whether it should gain preemption rights through its parent national bank. The OCC has promulgated a regulation which states “[a] national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority . . . .” Additionally, the OCC has determined that “[a]n operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank.” To conduct business through an operating subsidiary, a national bank must receive OCC approval and complete an extensive application process. In some instances, national banks that are “well-capitalized” and “well-managed” are only required to file “written notice within 10 days after acquiring or establishing the subsidiary.” The OCC will review the application “to determine whether the proposed activities are legally permissible and to ensure that the proposal is consistent with the safe and sound banking practices and OCC policy and does not endanger the safety or soundness of the parent national bank.”

34. First Union Nat’l Bank v. Burke, 48 F. Supp. 2d 132, 144 (D. Conn. 1999). See also Guthrie v. Harkness, 199 U.S. 148, 159 (1905) (stating that the National Bank Act “should contain a full code of provisions on the subject, and that no state law or enactment should undertake to exercise the right of visitation over a national corporation”).
35. See supra note 7.
40. A national bank is well-managed if the board of directors and management can adequately “identify, measure, monitor, and control the risks of an institution’s activities and [ ] ensure a financial institution’s safe, sound, and efficient operation in compliance with applicable laws and regulations.” FDIC, MANUAL OF EXAMINATION POLICIES: BASIC EXAMINATION CONCEPTS AND GUIDELINES (2000) in MACEY ET AL., supra note 39, at 652.
42. 12 C.F.R. § 5.34(e)(5)(iii) (2004).
2. Laws Applicable to Operating Subsidiaries

In addition to deciding what activities an operating subsidiary may engage in, the OCC has also determined what laws should apply to an operating subsidiary. Specifically, the OCC has issued a regulation stating: “State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.”43 The OCC’s rationale is that an operating subsidiary is treated as a department of its parent national bank and as such, it should follow the same regulations.44 Section 7.4006 was the primary regulation under attack in *Wells Fargo*.45

**D. Holding of Wells Fargo**46

On the issue of whether the California Department of Corporations was preempted from regulating an operating subsidiary of a national bank, the court held “the Commissioner has no visitorial powers over WFHMI.”47 Specifically, the court found that the OCC had authority to allow national banks, through an operating subsidiary, to engage in activities permissible for national banks to engage in directly.48 More importantly, the court held that it was reasonable and within its authority for the OCC to promulgate Section 7.4006.49

Finally, the court concluded that extending preemption rights to a national bank’s operating subsidiary does not violate state sovereignty under the Tenth Amendment.50 The court reasoned that once WFHMI became an operating subsidiary it “ceased being subject to the visitorial power of the Commissioner and became regulated by the OCC.”51 Accordingly, Wells Fargo was granted a permanent injunction enjoining the Commissioner from asserting visitorial power over WFHMI.52

III. ANALYSIS

**A. Legitimacy of Operating Subsidiaries**

In a recent regulation, the OCC asserts that national banks “may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly as part of, or incidental to, the business of banking . . . .”53 The Commissioner in *Wells Fargo* had an “equivocal position on whether the OCC can authorize national banks to conduct banking business through operating subsidiaries . . . .”54 Whether national banks can legitimately own operating subsidiaries is an important threshold

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45. *Id.*
46. *Id.* at 1162.
47. *Id.* at 1170.
48. *Id.* at 1169.
50. *Id.* at 1171.
51. *Id.* at 1170.
52. *Id.*
question in determining the validity of the OCC’s regulation granting operating subsidiaries the same preemption rights as national banks. Consequently, this issue must be decided.

The validity of Section 5.34 is determined by the standards for reviewing regulations issued by administrative agencies. Basically, the regulation must be both within the OCC’s authority as delegated by Congress and a reasonable interpretation of the National Bank Act. The first question to consider is what authority the OCC has to promulgate this regulation. Section 5.34 expressly states that the OCC has authority under 12 U.S.C. § 24 (Seventh) to allow national banks to conduct activities through an operating subsidiary. Accordingly, Section 5.34 is the OCC’s interpretation of the language in 12 U.S.C. § 24 (Seventh).

Section 24 (Seventh) states that national banks have the authority to:

- exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion, by loaning money on personal security, and by obtaining, issuing, and circulating notes . . . .

The OCC argues that conducting business through an operating subsidiary is “incidental” to the business of banking. The case law establishes that these incidental powers are not limited to activities that are absolutely necessary to carry on the business of banking, but rather include activities that are “convenient or useful in connection with the performance of one of the bank’s established activities pursuant to its express powers under the National Bank Act.”

Furthermore, throughout history there has been a debate over whether the language in Section 24 (Seventh) is exclusive or exemplary. However, the Supreme Court has recently issued an opinion putting this debate to rest. In Nationsbank of North Carolina v. Variable Annuity Life Insurance Co. (hereinafter VALIC), the Court expressly held that “the ‘business of banking’ is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.” The Court was nonetheless careful to note that the Comptroller’s discretion “must be kept within reasonable bounds.”

Since the Comptroller is the administrator responsible for the supervision of national

55. 12 C.F.R. § 5.34(a) (2004).
57. Wells Fargo, 265 F. Supp. 2d at 1165.
58. Arnold Tours, Inc. v. Camp, 472 F.2d 427, 432-33 (1st Cir. 1972) (holding national bank cannot operate a travel agency because it is not incidental to the business of banking as authorized by Section 24 (Seventh) of the National Bank Act).
59. Nat’l Retailers Corp. v. Valley Nat’l Bank, 604 F.2d 32, 34 (9th Cir. 1979) (holding “Valley National Bank, by failing to limit the use of its Retail Information Service to the performance of an express power under the National Bank Act, went beyond the bounds of those incidental powers granted to it by 12 U.S.C. § 24 (Seventh)”).
60. 513 U.S. 251 (1995) (upholding Comptroller’s decision to allow national banks to serve as agents in the sale of annuities).
61. Id. at 258 n.2. It is strange the Court would put such an important holding in a footnote. Even so, this holding has become the accepted interpretation of § 24 (Seventh).
62. Id.
banks, he “bears primary responsibility for surveillance of ‘the business of banking’ authorized by § 24 (Seventh).” \footnote{Id. at 256.} Two questions are considered when a court reviews an agency’s interpretation of a statute that it administers. \footnote{Id. at 842.} First, the court must consider “whether Congress has directly spoken to the precise question at issue.” \footnote{Id. at 843.} If not, the next question is “whether the agency’s [interpretation] is based on a permissible construction of the statute.” \footnote{Id. at 844.} Furthermore, it is established that a court should give deference to an agency’s reasonable interpretation of a statute that it administers. \footnote{Inv. Co. Inst. v. Camp, 401 U.S. 617, 636-37 (1971) [hereinafter ICI] (holding Comptroller’s regulation authorizing bank to operate investment funds violated the Glass-Steagall Act because it allowed banks to underwrite, issue, sell, or distribute securities).} As a result, Section 5.34 deserves this deference because it is the OCC’s interpretation of the National Bank Act. \footnote{See 12 C.F.R. § 5.34(a) (2004).} It is practical to give deference to the OCC’s interpretation, because the Comptroller has the expertise to make the best policy decisions concerning national banks. Additionally, conducting business through an operating subsidiary would definitely be convenient for a national bank. Accordingly, Section 5.34 is a valid regulation because it is a reasonable interpretation of the activities authorized in Section 24 (Seventh).

Section 5.34 also states that the OCC has authority under Section 24a of the National Bank Act to promulgate such a regulation. \footnote{12 C.F.R. § 5.34(a) (2004).} Congress has recognized the right of national banks to conduct business through operating subsidiaries in Section 121 of the Gramm-Leach-Bliley Act (GLBA), which allows national banks to own financial subsidiaries. \footnote{S. REP. NO. 106-44, at 8 (1999).} According to the GLBA, “[t]he term ‘financial subsidiary’ means any company . . . other than a subsidiary that . . . engages solely in activities that national banks are permitted to engage in directly . . . .” \footnote{12 U.S.C. § 24a(g)(3) (2000).} This definition implicitly accepts the fact that national banks can own operating subsidiaries. Additionally, a Senate Report from the GLBA indicates that national banks have a history of being able to own operating subsidiaries. \footnote{S. REP. NO. 106-44, at 8 (1999).} The fact that Congress has endorsed a national bank’s ownership of an operating subsidiary is another convincing argument that Section 5.34 is a valid regulation.

Another compelling justification for validating Section 5.34 is by analogy to the legitimacy of operating subsidiaries in the context of federal savings and loan associations (also known as thrifts or savings banks). The Office of Thrift Supervision...
Preemption Rights of National Bank Operating Subsidiaries

(OTS), the agency charged with the responsibility of regulating federal savings and loan associations, has the authority to “prescribe such regulations and issue such orders as the Director [of the OTS] may determine to be necessary for carrying out [the Home Owners’ Loan Act].” Pursuant to this power, the OTS promulgated a regulation allowing a federal savings and loan to own an operating subsidiary. As in the case of a national bank, an operating subsidiary of a thrift may engage “only in activities that a Federal savings association may undertake directly.”

The OTS regulation was unsuccessfully challenged in a recent case in which WFS Financial Inc. (WFS) was approved as an operating subsidiary of Western Financial Bank, a federal savings and loan association. WFS was a corporation in the state of California, but was authorized to conduct business in Wisconsin as a “sales finance company.” WFS objected to the state law requiring it to obtain licenses and register in Wisconsin to conduct its business. State officials in Wisconsin did not agree that, as an operating subsidiary of a federal savings bank, state laws were not applicable to WFS. The court in WFS Financial, Inc. could find “no basis on which to conclude that the Office of Thrift Supervision exceeded its delegated authority when it promulgated regulations permitting federal savings and loan associations to acquire and operate subsidiaries . . . .”

The OTS regulation authorizing federal savings banks to own operating subsidiaries specifies that “an operating subsidiary may engage in only those activities its parent is legally authorized to undertake directly.” When passing the regulation, the OTS determined that allowing federal savings banks to own operating subsidiaries would maximize efficiency, spread costs, and enhance the safety and soundness of the federal savings bank. Likewise, an operating subsidiary of a national bank protects safety and soundness and federal deposit insurance funds. For example:

[ina subsidiary’s earnings accrue directly to the benefit of the parent bank, and help diversify the bank’s earnings. More importantly, if the bank ever gets into trouble, the bank’s depositors and the FDIC have a claim on the bank’s ownership interest in the subsidiary; that interest can be sold to replenish the bank’s capital or reduce the FDIC’s loss.
The OCC and OTS have similar powers when it comes to regulating their respective entities and determining activities that are “incidental” to the business of that entity. Given the similarities of the type of activities national banks and national savings and loan associations are engaged in, and the similar regulatory scheme, it does not make sense to allow one entity to own operating subsidiaries and not the other. Accordingly, the court in Wells Fargo correctly determined that Section 5.34 was “within its discretionary authority delegated to it by Congress and is a reasonable interpretation of the [National Bank] Act.”

B. Preemption Rights of Operating Subsidiaries

1. Validity of Section 7.4006

Since it has been determined that a national bank can legitimately own an operating subsidiary, the next question concerns which laws are applicable to an operating subsidiary. In a regulation, the OCC declares that “[s]tate laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.” The validity of Section 7.4006 is important because if this section is within the OCC’s authority then the Commissioner is preempted from exercising visitorial power over WFHMI, just as it is preempted from exercising visitorial power over national banks such as Wells Fargo. In Wells Fargo the Commissioner specifically challenged the OCC’s authority to issue Section 7.4006. While it is true that the regulation does not expressly state any authority for its promulgation, the OCC contends that “Congress implicitly authorized it to promulgate this regulation in the incidental powers section of 12 U.S.C. § 24 (Seventh), the visitorial powers section in 12 U.S.C. § 484, and through acknowledgement in the Gramm-Leach-Bliley Act . . . that national banks can have operating subsidiaries.”

Like Section 5.34, Section 7.4006 is another OCC interpretation of Section 24 (Seventh), and therefore, its validity is determined by using the standards set out in Chevron. As indicated earlier, a Chevron analysis involves two questions: (1) whether Congress has spoken on the issue and (2) whether the agency’s interpretation is reasonable. Congress has not spoken on the issue of laws applicable to operating subsidiaries of national banks. As a result, the regulation should be accepted if it is reasonable.

Reasonableness is not based on agreement, and a court should not decide a regulation is unreasonable because it does not agree with the Comptroller’s specific

Subsidiaries of Banks, in MACEY ET AL., supra note 39, at 501.
88. 265 F. Supp. 2d at 1165 (citing Def.’s Opp’n to Pls.’ Mot. for Summ. J. at 3).
89. Id.
91. Id.
92. Id. at 843.
decision. Alternatively, the reasonableness of Section 7.4006 is dependent on whether it is “convenient or useful” to regulate national banks and operating subsidiaries in the same manner. As a matter of efficiency and predictability, it would clearly be convenient to have a single regulatory scheme for national banks and operating subsidiaries. Additionally, there is deference afforded to an agency when it interprets a statute that it administers. This is logical given the Comptroller’s expertise to make policy decisions about the national banking system. Accordingly, the court in Wells Fargo correctly followed the principles set out in Chevron in holding that Section 7.4006 is a reasonable interpretation of the National Bank Act.

Additionally, just as in the case of Section 5.34, the validity of Section 7.4006 can be established by analogy to federal savings and loan associations. For instance, in the context of federal thrifts, the parent entity and its operating subsidiary “are generally consolidated and treated as a unit for statutory and regulatory purposes.” This is because an operating subsidiary of a federal savings bank is treated as “a department or division of its parent for regulatory purposes.” As a result, the OTS regulation concerning the laws applicable to operating subsidiaries of federal savings and loan associations provides that state laws preempted with respect to the parent thrift are also preempted with respect to its operating subsidiaries. Given the similarities of the governing statutes and entities themselves, and since it is reasonable for the OTS to give operating subsidiaries of federal thrifts the same preemption rights as their parent entity, by analogy it is reasonable for the OCC to do the same.

The statutory framework and analogy to the situation of federal savings and loan associations provide strong support for the conclusion that Section 7.4006 is a reasonable regulation. However, there are also convincing policy reasons for having state laws apply to operating subsidiaries to the same extent that they apply to their parent national bank. In promulgating its regulations, the OTS determined that “it could not fulfill the act’s statutory mandates unless it regulated the operating subsidiaries in the same manner and to the same extent that it regulated their parents . . . .” The court in WFS Financial, Inc. felt this was a reasonable conclusion, because “to the extent the operating subsidiaries are restricted by state regulation, they could not improve the safety, soundness and availability of credit of their parent organizations.” Likewise, the policy to enhance efficiency, safety, and soundness holds true in the context of national banks and their operating subsidiaries.

2. Visitorial Power over Operating Subsidiaries

In the context of visitorial powers, once the validity of Section 7.4006 is accepted, the California Department of Corporations is preempted from exercising visitorial control over operating subsidiaries of national banks. As stated before, the term “visitorial

93. Id. at 843, n.11.
94. See supra note 58 and accompanying text.
96. 12 C.F.R. § 559.3(h) (2004).
98. Id.
100. WFS Fin. Inc., 79 F. Supp. 2d at 1027.
powers” refers to:

the power of the OCC to ‘visit’ a national bank to examine its activities and its observance of applicable laws, and encompasses any examination of a national bank’s records relative to the conduct of its banking business as well as any enforcement action that may be undertaken for violations of law.101

As a result, the Commissioner would be preempted from asserting regulatory, enforcement, or examination authority over Wells Fargo. This definition covers the actions taken by the Commissioner in Wells Fargo.

There are persuasive policy reasons for concluding that the Comptroller has exclusive visitorial power over operating subsidiaries of national banks. First, allowing the Commissioner to exercise visitorial powers over WFHMI would “result in unnecessary and wasteful duplication of effort on the part of the bank and the state agency.”102 Additionally, since an operating subsidiary is treated as a department of the bank, having a single regulator avoids “confusion [that] would necessarily result from control possessed and exercised by two independent authorities.”103 Finally, given his expertise, the Comptroller is in the best position to properly regulate and make policy decisions concerning national banks and operating subsidiaries. In summary, the OCC as a regulator for both national banks and operating subsidiaries is both practical and efficient.

C. State Sovereignty Concerns

The Tenth Amendment to the Constitution protects state sovereignty, stating, “[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”104 A major concern of the Commissioner in Wells Fargo, and subsequently among other state regulators, is that giving operating subsidiaries the same preemption rights as their parent national bank ultimately infringes on state sovereignty.105 Specifically, the Commissioner in Wells Fargo believes that, as a general corporation chartered in the state of California, WFHMI should be under his control and subject to the laws applicable to other general corporations.106 To the contrary, Comptroller Hawke believes the states are actually upsetting the principles of federalism by trying to regulate in an area historically off-limits.107 Hawke posits that there is a political motive for the states’ recent

102. Nat’l State Bank, Elizabeth, N.J. v. Long, 630 F.2d 981, 988 (3d Cir. 1980) (holding that the New Jersey statute requiring mortgage statistics disclosure was preempted by the Home Mortgage Disclosure Act and the New Jersey antirefunding statute was applicable to national banks, but enforceable exclusively by the OCC).
103. Easton v. Iowa, 188 U.S. 220, 232 (1903) (holding that state criminal law prohibiting insolvent national banks from knowingly accepting deposits was preempted by federal statute).
104. U.S. CONST. amend. X.
106. Id. at 1164.
aggressiveness in attempting to exercise regulatory control over national banks.\textsuperscript{108} He believes the states have gone too far in recent attempted legislation, and have in fact infringed on constitutional principles.\textsuperscript{109}

The states have known for a long time that courts, including the Supreme Court, uphold the OCC’s preemption of state law.\textsuperscript{110} Recent attempts by the states to exert control over national banks have not only interfered with state sovereignty, but they are costly in other ways. For example, “[t]hey also mean great expenses for banks, their trade associations, the OCC, and local taxpayers, who foot the bill for fighting laws that their elected officials should have known would not stand up in court.”\textsuperscript{111}

One prominent issue that arises in almost every Tenth Amendment challenge is whether a state executive is compelled to enforce or enact a particular regulatory scheme. The Supreme Court has unquestionably decided that it is unconstitutional for the federal government to direct states to implement or enforce a federal regulatory scheme.\textsuperscript{112} \textit{Printz} expressly held that executive action, as well as legislative action, that compelled state enactment or enforcement was unconstitutional.\textsuperscript{113} An important requirement in both \textit{Printz} and \textit{New York} was that the state officials would have had to affirmatively perform specific acts.\textsuperscript{114}

However, \textit{Printz} and \textit{New York} do not apply to the national bank regulatory scheme, because it “does not compel the Commissioner to enact or enforce a particular regulatory scheme, but rather has carved out from state control supervisory authority over federal instrumentalities.”\textsuperscript{115} Congress does not require the Commissioner to act in a specific way, but rather prohibits him from regulating national banks or their operating subsidiaries.\textsuperscript{116} Therefore, since he was not directed to enforce a federal regulatory scheme, the Commissioner cannot claim a violation of state sovereignty under the theory of \textit{Printz} or \textit{New York}. Nonetheless, the Commissioner in \textit{Wells Fargo} argues that the OCC’s regulation infringes on California’s state sovereignty because it takes away “the
state’s power to regulate and enforce its laws against state-chartered corporations such as WFHMI.\footnote{117}

Traditionally, states have the authority to regulate corporations chartered in their state.\footnote{118} However, an operating subsidiary is viewed as a department or division of its parent national bank. Thus, the classification of WFHMI as an operating subsidiary under Section 5.34 effectively changes the characterization of that entity. The court in \textit{Wells Fargo} specifically stated, “\cite{wells_fargo} when WFHMI became an OCC authorized operating subsidiary of a national bank it ceased being subject to the visitatorial power of the Commissioner and became regulated by the OCC.”\footnote{119}

Since WFHMI is no longer considered a general state-chartered corporation, but rather a department of the national bank, the appropriate question is not whether a state has the right to regulate a state-chartered corporation, but whether a state has the right to regulate a department of a national bank. Historically, in the field of banking, the regulatory scheme “has been one of dual control since the passage of the first National Bank Act in 1863.”\footnote{120} Therefore, federal law does not preempt the entire field of laws applicable to national banks. There are many areas in which the states retain power to regulate, such as: “contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.”\footnote{121} Even so, state banking laws may not “prevent or significantly interfere with the national bank’s exercise of its powers.”\footnote{122}

Alternatively, principles of federal preemption will apply if the state banking law conflicts with or impedes the federal banking law.\footnote{123}

As part of the National Bank Act, the visitorial power of the OCC over national banks and operating subsidiaries is part of an exclusive and complete regulatory scheme. Principles of federal preemption clearly say the states do not have the right to exercise visitorial power over national banks and operating subsidiaries.\footnote{124} Consequently, the court in \textit{Wells Fargo} correctly held Section 7.4006 did not interfere with state sovereignty by reasoning that

\begin{quote}
\textit{[t]he relegation of regulatory and supervisory authority over federal instrumentalities to a single federal regulator does not interfere with the Commissioner’s enforcement of state law against state banks, does not interfere with the state’s enactment of non-preempted state banking laws applicable to national banks, does not preclude the Commissioner from seeking OCC}
\end{quote}

118. \textit{Oregon Ry. & Navigation Co. v. Oregonian Ry. Co.}, 130 U.S. 1, 20 (1889) (stating the powers of a corporation “are such and such only as are conferred upon them by the acts of the legislatures of the several States under which they are organized”).
121. \textit{Bank of America v. City & County of San Francisco}, 309 F.3d 551, 559 (9th Cir. 2002).
124. See \textit{supra} notes 21-35 and accompanying text.
enforcement of state laws, and expressly leaves available judicial remedies to compel national bank compliance with state law.\(^{125}\)

**D. Consumer Protection Concerns**

From a legal and historical perspective, the *Wells Fargo* decision is sound. So why has it caused so much commotion in the banking industry? While *Wells Fargo* does not deal with consumer protection at great length,\(^{126}\) the heart of the debate that has resulted from the case focuses on consumer protection issues. State regulators and consumer protection groups are concerned that the “OCC’s legal strategy, if successful, will allow the [operating] subsidiaries to ignore consumer protection laws that are aimed at preventing abusive and predatory lending practices.”\(^{127}\)

In the wake of *Wells Fargo*, thirty-five state attorneys general and forty-three state bank commissioners have joined the fight to prohibit the OCC from shielding operating subsidiaries from state regulation.\(^{128}\) Many of the opponents of shielding operating subsidiaries from state regulation question whether the OCC actually knows how many operating subsidiaries it regulates, and furthermore, whether it has sufficient resources to regulate those operating subsidiaries.\(^{129}\) Comptroller Hawke is positive that the more than 2,500 OCC examiners can provide a satisfactory level of supervision.\(^{130}\) Hawke has also stressed that “there is ‘no evidence’ that national banks are engaged in predatory lending.”\(^{131}\)

In fact, Hawke says the states have avoided efforts to solve the consumer protection problems since he has asked state attorneys general to join in a cooperative effort with the OCC to address consumer protection issues, but has not received a serious response to this invitation.\(^{132}\) However, even if a cooperative system is not devised, the OCC will make sure that operating subsidiaries are in compliance with applicable laws.\(^{133}\) This would include any applicable consumer protection laws. The OCC is certain that it can and will protect consumers from unfair practices.\(^{134}\) According to Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel for the Office of the Comptroller of the Currency, “[w]e rigorously supervise national banks and their lending subsidiaries and there is scant evidence that they are the source of the predatory lending problem[s] in this country.”\(^{135}\) The bottom-line is that, one way or another, consumers will be protected.

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\(^{126}\) Id. at 1172. The court finds unpersuasive the argument of the Commissioner that California’s per diem statutes are designed to protect consumers and concludes the statutes regulate interest rates and amounts. Accordingly, the court concludes the per diem statutes are preempted by the DIDMCA without explicitly discussing consumer protection concerns.

\(^{127}\) Brian Collins, AGs vs. OCC, NATIONAL MORTGAGE NEWS, Sept. 1, 2003, at 1.

\(^{128}\) Id.

\(^{129}\) Cowden, *supra* note 107.

\(^{130}\) Id.

\(^{131}\) Collins, *supra* note 127.

\(^{132}\) Cowden, *supra* note 107.


\(^{134}\) Cowden, *supra* note 107.

Furthermore, the state attorneys general and state banking commissioners misunderstand the real effect of *Wells Fargo*. Operating subsidiaries are not given the power to preempt state consumer protection laws, or any state laws for that matter. Section 7.4006 simply provides that if a national bank is not subject to a particular state law, then neither is its operating subsidiary. 136 If the OCC or Congress decides that national banks, and consequently their operating subsidiaries, should follow a particular state law, then Section 7.4006 will not have any effect on that decision. This emphasizes the point that the question of which laws are applicable to national banks and their operating subsidiaries must be distinguished from the question of who is responsible for enforcing those laws. 137 In the case of national banks and their operating subsidiaries, the answer to the second question is clear—the OCC has exclusive power to enforce the laws. 138 The state attorneys general and state banking commissioners should respect that the OCC has the right to regulate national banks and their operating subsidiaries. Therefore, even if it is determined that a certain state law applies to a national bank and its operating subsidiary, that state law will still be enforced by the OCC.

IV. RECOMMENDATION

The legal and historical support for the Comptroller’s regulations concerning operating subsidiaries is very compelling. Nonetheless, it is important to consider the practical effects of those regulations. No one doubts the importance of the issues raised by the decision in *Wells Fargo*, but “[a]n incorrect legal conclusion . . . does not become correct simply because more people repeat it; the meaning of the law cannot be resolved through a popularity contest.” 139 Consumer protection is an important concern, but this concern should not be permitted to prevent the OCC from exercising its authority as delegated by Congress. Instead of worrying about laws that could possibly be preempted by the recent regulations, state banking regulators should work with the OCC to develop a cooperative scheme for dealing with consumer protection issues. Apparently this invitation has already been extended to state regulators, but the OCC has received no response. 140 The political motives for the assault on national banks should not be able to circumvent the clear authority of the OCC.

As the law now stands, *Wells Fargo* was correctly decided. The courts are not the forum for dissatisfied state regulators to wage a war against the OCC’s regulations. If state regulators continue to have concerns or the OCC’s regulation proves to be ineffective, then Congress should solve the problem. Congressional additions to the Riegle-Neal Act illustrate that Congress knows how to act when it feels the Comptroller is too aggressive in the area of preemption. 141 Currently, there is no evidence that

138. See 12 U.S.C. § 484 (2000) (stating that no national bank shall be subject to any visitatorial powers except as authorized by federal law); 12 C.F.R. § 7.4006 (2004) (indicating that unless otherwise provided by federal law or OCC regulation, state laws apply to national bank operating subsidiaries to the same extent that those laws apply to the national banks).
140. See Cowden, supra note 107.
141. Evan B. Berg, *Interstate Banking and Consumer Protection: Curtailing the Comptroller’s Preemption*
consumer protection is a problem for national banks or their operating subsidiaries. In fact, the OCC has a strong record in the area of consumer protection. If this changes in the future and the OCC is unable to remedy the problem, it is the job of Congress, not the courts, to provide a solution.

One possible solution would be a uniform consumer protection regulatory scheme that applies to both state and national entities. This is practical, because consumer protection is a universal issue that affects customers of state and national banks alike. Consequently, universal consumer protection laws would provide simplicity and efficiency for both consumers and regulators.

Establishing a national regulatory scheme for consumer protection issues that would apply equally to national and state banks would ease the tension between the competing entities and regulators. It would also lessen the confusion and uneasiness expressed by consumer protection groups. Comptroller Hawke states, “[w]hen national banks are unable to operate under uniform, consistent and predictable standards, their business suffers and so does the safety and soundness of the national banking system.” Consumers would also benefit from a universal regulatory scheme because the applicable law would be clear and free of legal surprises. In the interest of respecting the authority of the OCC and realizing the best result for consumers, the fight over visitorial power should be solved through a cooperative effort on the part of state and federal regulators.

V. CONCLUSION

Preemption has previously been an important issue for national banks, but Wells Fargo has added operating subsidiaries to the preemption debate. Now, not only are regulators of national banks at odds with state bank regulators, they are also quarreling with other state regulators, such as the Commissioner of the California Department of Corporations. Even though operating subsidiary preemption is a novel issue, Wells Fargo was correctly decided. The OCC has clear legal and historical authority to issue regulations establishing operating subsidiaries that are subject only to the same state laws as their parent national bank. However, it is the aftermath—the practical effects—of Wells Fargo that has raised the most concern. Nonetheless, the concerns about state sovereignty and consumer protection are unfounded. There are ways that these concerns can be resolved without limiting the OCC’s authority as delegated by Congress.

Even so, the issue presented in Wells Fargo is far from being settled. Passionate advocates on each side of the debate are not going to give up easily. In fact, experts have called the brief filed by numerous state attorneys general and banking commissioners in an upcoming case, concerning Wachovia Bank, “the most coordinated effort yet by state authorities to challenge a steady tide of preemption rulings that favor federally-chartered

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143. Comptroller Hawke has expressed that “[w]e have seen only isolated cases of abusive practices among national banks. But when we have identified problems, we have taken quick and effective action.” EFT Report, supra note 135.

144. EFT Report, supra note 135.
banks and thrifts. Furthermore, Wells Fargo is likely to be appealed to the Ninth Circuit. However, unless the court decides to take an unprecedented stand against the OCC’s clear legal and historical authority, the case should be affirmed.

145. P. Christian Bruce, Preemption: State Bank Chiefs, Attorneys General Unite to Support Connecticut in Preemption Case, 81 BANKING REP. (BNA) 330, Sept. 8, 2003. Wachovia Bank, N.A. v. Burke, 319 F. Supp. 2d 275 (D. Conn. 2004), a case identical to Wells Fargo, involving another operating subsidiary engaged in mortgage lending, was recently filed in the U.S. District Court in Connecticut. The state attorneys general and banking commissioners have filed an amicus brief in support of Burke, the Connecticut Banking Commissioner. Just as in Wells Fargo, the OCC has filed an amicus brief in support of Wachovia.