# Remarks by Chairman Donald E. Powell
## Chairman of the Federal Deposit Insurance Corporation
## Before the American Bankers Association Annual Convention
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Thank you. I am pleased to be here with you today.

For the past month, most of us in Washington (and, of course, the Gulf Coast) have been preoccupied with hurricanes and their aftermath—first Katrina, and this past weekend, Rita. I know I speak for everyone here when I say that our thoughts and prayers are with the people whose lives have been forever changed by these devastating natural disasters.

As for the FDIC, we have been doing all we can to assist the displaced victims as well as the insured institutions in the Gulf Coast area. In spite of the disruption and the distress, we are encouraged by the resilience and shear will of the people of Louisiana and Mississippi, and now Texas, to rebuild and restore what was lost.

Today, however, I am going to focus on the future of banking. I'm going to talk about the dual banking system that has served this nation so well for almost 150 years.

When I think of a strong dual banking system, I think of strong communities. I think of local and regional engines for economic growth and job creation. I think of choice, innovation and diversity.

I believe that the dual banking system is at a crossroads. The share of banking activity conducted through state-chartered banks is dwindling and there is every reason to believe that trend will continue. The issue goes well beyond market share, to fundamental issues about competitive fairness and states' ability to enforce laws protecting consumers.

It's not an exaggeration to say that this issue is of Constitutional proportions. It gets to the heart of how our federal union should work, and how much power rests with the states.

These days, any discussion of the future of the dual banking system must begin with the OCC's preemption regulations.

Ever since their creation in 1863, national banks have enjoyed some degree of exemption from state law. In Riegle-Neal, passed 130 years later, Congress provided that state laws would apply to the interstate branches of national banks in four key areas, as long as these laws are not preempted by federal law and do not discriminate against national banks on the basis of their charter. Those key areas—known as "the

big four"—are intrastate branching, consumer protection, fair lending and community reinvestment.

Since the passage of Riegle-Neal, OCC legal interpretations and court decisions have suggested that the preemption powers granted national banks are even greater than some might have imagined. In 2004, the OCC issued a regulation that preempts all state laws that obstruct, impair or condition a national bank's activities. This sweeping regulation contains no exception for state consumer protection, community reinvestment, fair lending or intrastate branching laws. Also, in its regulations, the OCC determined that state law is preempted for operating subsidiaries of national banks to the same extent that it is preempted for their parent national banks. For example, a consumer doing business with a mortgage company, title insurance company, finance company or retail securities brokerage may subsequently discover that some of his state's consumer protections do not apply, because these businesses are operating subsidiaries of a national bank.

Many sincere people believe the OCC's 2004 regulation was entirely correct; many equally sincere people believe it overreached. As with any truly tough issue, there are strong arguments on each side.

Ultimately, the courts, or Congress, will have to decide who is right. An "ultimate" end to uncertainty, in this case, could take many years. That is why most bankers, who have to plan their business based on today's realities, are probably considering OCC preemption as a fact of life.

The facts of life today with regard to preemption are fairly simple. A state-chartered bank that wants to do business across state lines is at a substantial competitive disadvantage relative to a national bank or federal thrift. The national bank or thrift can operate with somewhat uniform standards, while the state-chartered bank must comply with a far greater range of localized requirements in the states in which it does business.

Ironically, this situation is the opposite of what Congress intended when it passed Riegle-Neal II in 1997. In Riegle-Neal I, Congress did not give the same preemption rights to state-chartered banks that it gave to national banks. But within a few years, it became clear that state-chartered banks were operating at such a competitive disadvantage that it threatened the dual banking system. In response, Congress passed Riegle-Neal II, which preempted some host state laws for branches of out-of-state state-chartered banks.

The uneven playing field facing state-chartered banks that operate across state lines is affecting the proportion of assets in the state-chartered banking system. Until recently, the relative share of state-chartered-bank assets remained fairly stable at about 40 percent of commercial bank assets, with little change during both good times and bad. In the past two years, however, that share has dropped to just over 30 percent at the end of March. Among commercial banks with interstate branching networks, the

proportion is even higher; almost 80 percent of the assets of interstate banks are in national banks. Twenty years ago, four of the ten largest banks were state chartered, including the fourth-fifth-, sixth- and seventh-largest insured commercial banks. At the end of March, only one of the ten largest insured commercial banks had a state charter. That bank was the last on the list.

While the share of assets of state-chartered banks has dropped, the percentage of state-chartered banks has increased. In the 1980s, two-thirds of all commercial banks were state chartered. Now, three-quarters of all banks are state-chartered. In short, we are seeing a state banking system that is increasing in relative numbers and decreasing in relative size.

Going forward, there is every indication the relative decline in the assets of state-chartered banks will continue. Today, more than three out of every four new commercial banks opt for state charters when they start up. When banks reach a certain size and their geographic operations expand beyond a single state, though, the pressures to switch to a national charter, whether through merger or charter conversion, become hard to resist.

In my view, there is little doubt what the current competitive imbalance, if not addressed, means for the future. The state-chartered banking system is headed for being a system of small banks competing under a different set of rules than their larger counterparts. These small state institutions will be important within their own communities, but make no mistake, they will conduct less and less of the nation's banking business—and they will be in the ranks of the acquisition targets, not the acquirers.

Many people see this trend as an unfortunate development that portends more concentration of banking and regulatory power, perhaps even a gradual loss of local and regional economic autonomy.

A few months ago, the Financial Services Roundtable submitted a petition to the FDIC to publish a regulation that would address these issues. Essentially, the petition asked the FDIC to determine that state-chartered banks operating across state lines enjoy the same preemption of host state laws that national banks do. In other words, a state-chartered bank would be allowed to operate nationwide under the laws and regulations of its home state, to the same extent a national bank could operate nationwide under the laws and regulations applicable to national banks.

On May 24, we held a public hearing at the FDIC to help us decide how to respond to the petition. We heard from bankers and lawyers, trade groups and consumer groups, and a number of state banking commissioners. We met all day. I heard every session and I can assure you it was a great day of testimony.

We heard articulate, thoughtful views, but no agreement on how the FDIC should proceed. Some witnesses said current state laws discriminate against some financial service providers in a way that violates the intent of the Gramm Leach Bliley Act. Those

witnesses said the FDIC can, and should, act to remedy the uneven playing field that now exists between federal and state institutions. Others said the FDIC cannot, and should not, address the issue, and expressed concern about a race to the bottom, where states would compete for charters by relaxing their consumer protection laws.

I understand the passions on consumer protection, but I do not see the real choice as being between host state consumer laws and home state consumer laws. I see it as being between some state consumer laws and no state consumer laws. Let me explain.

Every state and national bank has to comply with a baseline of federal consumer protection law. If we cannot adequately protect consumers using federal law, then we have a serious consumer protection problem that needs to be addressed at the national level, regardless of what happens with this petition. If consumers would be endangered by doing business with an out-of-state state-chartered bank that must comply with federal law, they must be at least as endangered by doing business with a national bank today.

What's more, if the relative decline in the assets of state-chartered banks continues, as I think it will if nothing is done, more and more consumers will be dealing with national banks, which, under the OCC's regulations, are not subject to most state consumer protection laws. Congress recognized this problem when it passed Riegle-Neal II. Representative Marge Roukema, the principal sponsor of the legislation, said at the time that, "The essence of this legislation is to provide parity between state-chartered banks and national banks," but she added that, "This legislation is also important for consumers, because if we do not enact this legislation, State banks will likely convert to a national charter. . . . The end result could be that there will be no consumer protection at the state level. . . ."

Riegle-Neal II clearly eliminates the disparity between the treatment of national bank branches and state-chartered-bank branches with respect to host state law. This is black letter law from Riegle-Neal II, which has been codified into the Federal Deposit Insurance Act. In light of what we heard at the hearing, though, I think that we should consider whether additional clarity from the FDIC might be beneficial.

For example, Riegle-Neal II leaves several unanswered questions—several gaps—concerning the scope of the preemption rights of state-chartered banks. Among the most obvious of these is a state-chartered bank's right to invoke Riegle-Neal II when an activity is conducted through an operating subsidiary.

A few months ago, I asked the staff to bring these issues before the FDIC Board for its consideration. I was not committed to a particular response to the petition. In fact, I wanted to put out a range of options and get comments from you and the public.

The majority of the Board, however, preferred to forego public comment on the range of options and instead is considering a specific proposal implementing Riegle-Neal II's provisions. I expect staff will present this proposal to the Board soon. It is premature to

speculate what the outcome of the Board's deliberations will be or even whether it will put the proposal out for public comment. What is absolutely clear to me is that the FDIC, as a federal regulator, has a responsibility to implement all existing laws for state-chartered banks. And we should do so in a manner consistent with the letter of the law and intent of Congress, and in a way that is unambiguous for those to whom it applies.

Equally clear is that the state banking system is at an important fork in the road.

Inaction at the federal level will keep us on the road where states retain their unchallenged regulatory sovereignty—but only over the dwindling fraction of banking activity that is not conducted through federally chartered institutions. It is ironic that if this path is followed in the name of consumer protection, most consumers will end up doing business with federally chartered institutions, and the states' role in consumer protection will have been diminished.

It is theoretically possible that the share of assets in the state system will stabilize or be reversed without federal action. This result, however, seems unlikely, unless each state, somehow, relinquishes some regulatory control in the interests of a more uniform and competitive playing field for state-chartered banks. None of us knows today how or if this can occur, and many do not agree that it should occur.

Action at the federal level is the only real hope of preserving the dual banking system that we have known in the past. Even if the FDIC takes regulatory action, however, it may not completely level the playing field for state chartered and national banks.

Ultimately, Congress will have to decide this issue, in my opinion. The important questions of federalism it presents—the ability of banks to effectively compete in interstate commerce and state's interest in consumer protection—call inevitably for congressional decision making. In the end, Congress may choose to level the playing field and preserve the dual banking system or it may, through inaction or otherwise, choose not to, and let the dual banking system fade into history. In my opinion, that would be a mistake.

Thank you.

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