Remarks by
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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. The dual banking system is a unique strength we have long enjoyed in this country.

I think everyone in this room understands that the dual banking system is at a crossroads. The share of banking activity conducted through state 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 states' ability to enforce laws protecting consumers.

I am going to talk today about these trends and about a petition the FDIC received to expand certain preemptions for state banks. I will also discuss a recent public hearing we had at the FDIC on these issues. Since much of this relates to the OCC's 2004 preemption regulation, I will start there.

Ever since their creation in 1863, National Banks have enjoyed some degree of exemption from state law. In Riegle-Neal, Congress provided for state law to apply to the interstate branches of national banks in four key areas, as long as these laws did not discriminate against national banks on the basis of their charter. Those key areas—known as "the big four"—are interstate branching, consumer protection, fair lending and community reinvestment.

OCC legal interpretations and court decisions since Riegle-Neal suggest that a number of specific state laws that might have seemed to be within the big four are preempted. Also, the OCC regulation determined that a national bank's preemptions extend to its operating subsidiaries. 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 subsidiaries of a national bank.

I have read Superintendent Taylor's Congressional testimony on this issue, and it is powerful, passionate testimony. I will read one paragraph aloud, because it truly captures just how fundamental these issues are. She wrote:

"Ultimately, you must decide whether you are comfortable putting your constituents in the hands of an unelected official who, with the stroke of a pen, seeks to sweep aside all state consumer protection laws, and has effectively declared all national banks and their operating subsidiaries in your state exempt from the authority of your Governor, your state's Attorney General, your state legislature and your state's financial regulators."

This language transcends 21st century banking. It gets to the heart of how our federal union should work. This is Andrew Jackson language. This is 1787, the Constitutional convention.

Now like any truly tough issue, there is more than one side to this story.

While many people sincerely believe the OCC's 2004 regulation was an overreach, it is the courts, or perhaps Congress, that ultimately will decide. 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 wishes to do business across state lines is at a severe competitive disadvantage, compared to a national bank or federal thrift. The national institution can operate with somewhat uniform standards, while the state bank must comply with a far greater range of localized requirements in the states in which it does business.

No one I know in banking is complaining about compliance with the law. Every banker I know wants and expects to comply with the law. The issue for these is simply the expense and business uncertainty when laws and requirements for the same activity are different from state to state.

I understand and respect that the states have been laboratories for innovation in the area of consumer protection. A state can be far more nimble than the federal government, and you have led the way in addressing abusive practices where federal regulators were slow to act.

The flip side, of course, is you are now victims of your own innovation and diversity of practice. And that is because many state bankers, who have no intention to defraud or exploit their customers, now believe they can more efficiently serve those customers under a national charter.

The un-level playing field facing state banks that operate across state lines is affecting the proportion of assets in the state system. Until recently, the relative share of state bank assets remained somewhat stable between 40 and 45 percent of commercial bank assets, with little change during both good times and bad. Through recent consolidation, the assets of the system are becoming increasingly concentrated in national banks, and at the end of last quarter, the share of assets held by state banks fell to 33 percent. At the end of March, only one of the ten largest insured commercial banks had a state charter. That bank was the ninth-largest. Twenty years earlier, four of the ten largest banks were state-chartered, including the fourth-, fifth-, sixth- and seventh-largest insured commercial banks.

The trends on the number of state chartered banks are markedly different. In the 1980's, state chartered banks were about two-thirds of all commercial banks and from the early 1990's this has risen steadily to 75 percent. In short, what we seem to be seeing is 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 banks will continue. I am sure many of you are aware of large state-chartered banks that are seriously considering life under a national charter. In my view, there is little doubt what the current competitive imbalance, if not addressed, means for the future. The state system is headed for being a network of small banks. 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.

Recently, 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 banks operating across state lines enjoy the same preemption of host state laws as if they were a national bank. In other words, a state 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 including John Allison, who testified on your behalf. We started before nine AM and ended after four thirty. 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 un-level 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. For a regulatory agency being asked to interpret the law, however, I think we have to treat this primarily as a legal issue. Every state and national bank has to comply with a baseline of federal consumer protection law. If we believe bank supervisors 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 bank that must comply with federal law, they must be equally endangered by doing business with a national bank today.

And what about the legality? It is clear that a state bank's branch in another state enjoys the same preemptions as a national bank's branch. That is black letter law from Riegle-Neal, that has been codified into the Federal Deposit Insurance Act. We assume that most state banks doing business interstate are aware of this, but we will certainly consider whether additional clarity from the FDIC might be beneficial.

More broadly, I think it is hard to dispute that state banks that wish to do business interstate are not now operating on a level playing field with federally chartered institutions. Current regulatory arrangements and laws appear fundamentally tilted in favor of a federal charter, and some very thoughtful people have questioned whether this lack of parity between the state and federal charters is consistent with Congressional intent to preserve a strong dual banking system.

A number of witnesses at our hearing said there is need for more dialogue on this issue, and that this should be resolved in Congress, not by a regulator. Undoubtedly there is need for more dialogue. But this is one of those issues where all the dialogue in the world is not going to make the decisions any easier. On the regulator versus Congress question, it is a regulator's job to implement the law. The OCC believes that it is implementing the law for national banks, and we have been asked to implement the law for state banks.

Because I think the kind of public debate and discussion that will result is a healthy thing, I have asked the staff to bring these issues before the FDIC Board for its consideration. This does not mean I am committed to a particular response to the petition. It does mean that I believe it is appropriate for the FDIC Board to decide whether and how to act on the petition.

It is premature to speculate what the outcome of the Board's deliberations will be. What is clear, however, is that the state banking system is at an important fork in the road.

One possibility is that states will 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.

Another possibility might be that the share of assets in the state system will stabilize or be reversed. 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 banks. None of us knows today how or if this can occur, and many do not agree that it should occur. But as a number of witnesses at our hearing said, inaction is a choice—and most likely, a choice to relegate the dual banking system to the history books.

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