December 13, 2005

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Preemption Petition; Interstate Banking; Federal Interest Rate Authority

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the FDIC's proposal to adopt two rules to clarify which law is applicable to state chartered banks that operate branches in other states. The proposal is the result of a petition filed last December requesting the agency to take action to restore parity between state banks and national banks. Essentially, the proposal would codify and clarify two federal statutory provisions for state-chartered banks. Generally, the first rule would implement a provision of the 1997 "Riegle-Neal II" law[2] and preempt host state law for the activities of a

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $631 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[2] As revised, the pertinent section of Riegle-Neal II states that "the laws of a host state, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of interstate branches, shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch in the

branch of an out-of-state state bank to the same extent host state law is preempted for the activities of a branch of an out-of-state national bank. The second rule would clarify the interest rates that state banks may charge, including the ability of state banks to "export" interest rates across state lines.

Summary of ICBA Position

The ICBA supports the proposal to codify Riegle-Neal II, section 24(j) of the Federal Deposit Insurance Act, as a means to foster parity between the activities of branches of out-of-state state banks with those of out-of-state national banks. The statute provides that a state's law applies to the activities of an out-of-state branch of a state bank to the same extent the law applies to the activities of an out-of-state branch of a national bank. However, the ICBA also urges the FDIC to incorporate a mechanism in the final rule to ensure that state banks can determine whether a state law is preempted in a timely manner in the absence of a federal court order or written determination by the Office of the Comptroller of the Currency (OCC).

The ICBA also supports the proposal to codify section 27 of the Federal Deposit Insurance Act and clarify what interest an out-of-state state bank may charge.

Generally, the ICBA agrees that action should be taken to address current disparities between state and national banks and to preserve the dual banking system. The ICBA believes that the FDIC proposal is appropriate and supports the agency's proposal, with some revisions for clarification. Unless action is taken, the ICBA is concerned that the balance in the dual banking system will continue to tip as more banks with interstate operations elect a national charter to operate under a single set of rules and standards.

Ultimately, Congress may need to act, both to resolve any questions over the FDIC's authority to take additional steps and to address critical policy implications for the dual banking system. The dual banking system has served the United States well and allowed community banks to remain viable. However, until Congress acts, the ICBA supports the FDIC taking this step to codify existing sections 24(j) and 27 of the Federal Deposit Insurance Act to help maintain parity between state and national charters.

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host State of an out-of-State national bank. 12 USC 1831a(j)(1), section 24(j) of the Federal Deposit Insurance Act.

Background

Early in 2004, the OCC adopted a preemption regulation that in part led to the current FDIC proposal. The OCC's rule, intended to provide clarity and allow national banks to operate under a single set of standards, generally preempted state laws that would otherwise restrict, limit or condition deposit-taking or lending activities of the branch or operating subsidiary of a national bank.[3] When the OCC acted, concerns were raised about the potential impact of its rule on the dual banking system. Some contended it would undermine dual banking by encouraging banks with interstate operations to convert to a national charter to be able to operate under a single set of rules instead of a patchwork of differing state laws. While supporting the concept of preemption, the ICBA urged the OCC to continue to preempt state laws on a case-by-case basis instead of adopting a general preemption rule.

To help restore parity between national and state banks after the OCC adopted its preemption rule, the FDIC was petitioned to adopt a parallel rule preempting host state laws that might otherwise apply to the interstate operations of out-of-state state banks, including the activities of branches, operating subsidiaries, loan production offices and the bank in general. In part, the petition asked the FDIC to codify provisions of Riegle-Neal II to restore parity between state and national banks by allowing a state bank to operate under a single set of laws (that of its home state) instead of having to follow varying and sometimes conflicting state laws in other states where it maintained a branch. The petition argued such a rule was also needed to avoid encouraging all banks with interstate operations to convert to a national charter to be able to operate under a single set of rules. Currently, slightly less than half of the 100 largest banks have state charters.

Last May, the FDIC held a hearing to discuss the issues raised by the petition. Some who favor the FDIC adopting a preemption rule, including a number of state banking commissioners, testified that FDIC action would help maintain both the dual banking system and parity between state and national banks. On the other hand, consumer groups contended that an FDIC preemption rule would cause a "race to the bottom" where states would minimize or eliminate consumer protection laws to encourage banks to establish operations in those states. ICBA testified that the balance in the dual banking system needs to be restored, but questioned whether the petition went too far and whether the FDIC, as opposed to Congress, should resolve the issue.

In July, the FDIC board initially considered a broader preemption rule, but when the board could not reach agreement, that proposal was tabled. In its place, the FDIC has now issued the current, more limited proposal. This proposal would codify two federal statutory provisions on the interstate

[3] A second rule adopted at the same time affirmed the OCC's exclusive supervisory authority over national banks.

operations of state-chartered banks. Because merely repeating the two statutory provisions might create confusion, the FDIC also proposes to add language clarifying certain definitions.

The Proposal

State Law Preemption

The first proposed rule would preempt host state law for the activities of a branch of an out-of-state state bank to the same extent that state law is preempted for the operations or activities of a branch of an out-of-state national bank. Where host state law is preempted for the activities of the out-of-state state bank, the laws of the state where the bank is chartered (its home state law) would apply.

To help provide clarity, the rule would define "home state," "host state" and "activity conducted at a branch." "Home state" and "host state" would parallel the statutory provisions.[4] However, since operations involving a particular transaction can take place in more than one location,[5] the rule would define "activity conducted at a branch" as "any activity by, through, in, from or substantially involving a branch."

ICBA Comment. The ICBA supports the proposed definitions as a means to provide additional clarity to the statutory definitions. Although the proposed definition of "activity conducted at a branch" is broad, the ICBA finds it appropriate due to the highly dynamic nature of today's banking industry. Community banks engage in many activities that would not have been foreseeable even 10 years ago, and it is critical that any rule issued today be sufficiently flexible to allow such dynamic development to continue to take place. Flexibility is especially important to allow community banks to respond to competition.

The proposed preemption rule would apply to *branch* activities, as specified by Riegle-Neal II. However, for full parity between state and national banks, preemption would need to extend to the activities of operating subsidiaries of out-of-state banks. Although this may be outside the scope of the provisions of Riegle-Neal II and the FDIC's authority, since activities of operating subsidiaries have become more prevalent since the statute was enacted, it is

[4] A bank's "home state" is defined by statute as the state where a national bank has its main office or the state where a state bank is chartered, while a "host state" is any state other than the bank's home state where the bank has or seeks to open a branch. 12 USC 1831(u)(g)(4 and 5).

[5] For example, a loan application might be taken at a branch, the information needed for underwriting the loan assembled at an operations center in another location, the actual underwriting decision made in another office, and funds disbursed to the borrower from still another location.

important that review and discussion of the issue continue to ensure parity for operating subsidiaries of both state and national banks.[6]

Requirement for Prior OCC Written Determination or Court Ruling for Preemption. During the FDIC board's discussion of the proposal, Comptroller of the Currency John Dugan offered an amendment that was incorporated into the proposal. Under the amendment, before the law of a host state can be preempted for the activities of a branch of an out-of-state state bank, there must be either a federal court ruling or a prior written determination by the OCC that the state law in question was preempted for national banks.

ICBA Comment. Generally, the ICBA does not disagree with the premise for the amendment. However, while the intention was to avoid placing the FDIC in the position of interpreting how the OCC might apply the National Bank Act to national banks, the amendment creates other problems that must be addressed. As currently worded, the proposal would require a finding that a *particular* state law had been preempted. Ironically, the OCC preemption rule creates a general preemption for certain state laws in order to avoid having to determine that a particular state law is preempted for the activities of a national bank.[7] As a result, there will very likely be instances when the OCC has not made a finding that a particular state law has been preempted for national banks. This fails to establish clear parity for state banks and forces state banks to resort to federal courts to resolve whether a particular state law would be preempted for national banks, a costly and time consuming proposition.

To rectify this situation, the ICBA recommends that the final rule be revised to require the OCC to respond within 30 to 90 days to any request from the FDIC for a written finding that a particular state law would be preempted for the branch of an out-of-state national bank. If the OCC does not respond within that timeframe, the final rule should allow the FDIC to make an independent determination on preemption. Otherwise, state banks could be forced to wait for untenable periods for a preemption determination.

Interest Rates

The second rule, also designed to foster parity between state and national banks, clarifies what law governs the interest rates a state bank may charge. Generally, following existing rules for national banks and federal thrifts, the proposal would codify section 27 of the Federal Deposit Insurance Act[8] and two

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[6] It is worth noting that a case currently pending before the United States Supreme Court, *Burke v. Wachovia Bank,* is assessing the OCC's authority to preempt state laws as applied to operating subsidiaries of national banks.

[7] The ICBA continues to believe that it would be preferable to make preemption determinations on a case-by-case.

[8] Section 27, patterned after section 85 of the National Bank Act, provides that a state bank may charge the greater of: (a) the rate prescribed for state banks under state law, if any; (b) one percent more than the discount rate on 90 day commercial paper in effect at

long-standing FDIC general counsel opinions and clarify that a state bank may charge the greater of: (a) the rate permitted for state banks chartered by that state; (b) 1% over the 90-day discount rate for commercial paper set by the Federal Reserve Bank for that district; or (c) the rate allowed by the laws of the state where the bank is located (its home state and any state where it has branches). In other words, a state bank could charge interest permitted by the state where it has a branch or "export" interest rates from its home state to the same extent as a national bank.[9]

ICBA Comment. The ICBA supports this approach. As with the preceding part of the proposal, this will help foster parity between state and national banks. The ICBA also agrees that out-of-state state banks should be allowed to "export" interest rates permitted by their home state. Inability to do so in today's environment would create both regulatory and operational burdens.

Where Transactions Occur. A state bank that does not operate interstate branches or only operates over the Internet would be deemed located in the state where it is chartered. For state banks that maintain a physical presence in another state, the proposal would outline three "non-ministerial functions" associated with lending used to determine where a bank is located for determining permissible interest rates: (1) approval; (2) disbursal of the funds; and (3) initial communication of approval to the borrower. If all three functions occur in the same state, then that state's law would apply, but if elements occur in more than one state, the bank's home state law would apply.

ICBA Comment. The ICBA agrees these functions are appropriate for determining where a loan is made and which state's law applies. However, since determining where a particular transaction takes place is assuming increasing significance, the ICBA encourages the FDIC to work with the other federal banking regulators and other interested parties to develop a coherent and comprehensive approach to where activities and transactions are deemed to occur. With an increasingly mobile society and expanding reliance on technology for financial services, this issue requires careful analysis and appropriate resolution from a public policy perspective. The ICBA welcomes the opportunity to work with the agencies on the issue.

The proposal would also provide that if a loan has a clear connection to a host state where the bank operates a branch, then the host state's laws would apply (based on all the facts and circumstances). The ICBA believes this is appropriate and supports incorporating this element in the final rule.

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the Federal Reserve bank for the Federal Reserve district where the bank is located; or (c) the rate allowed by the laws of the state, territory or district where the bank is located.

[9] The term "interest" would be defined to include any payment that compensates a creditor for an extension of credit, making available a line of credit, or any default or breach of a condition of the credit. Among other fees, it would include periodic rates, late fees, insufficient funds fees, overlimit fees, annual fees and membership fees.

"*Most Favored Lender" Status.* Finally, the rule would provide that state banks, like national banks and federal thrifts, are eligible for "most favored lender" treatment that allows a bank to charge the highest rate permitted for any lender in the state. The ICBA strongly supports this element of the proposal.

Conclusion

Generally, the ICBA supports the FDIC adopting this proposal to help foster parity between state and national banks by implementing two statutory provisions of the Federal Deposit Insurance Act, sections 24(j) and 27. The need to maintain parity between the two charters was clearly recognized by Congress when it adopted Riegle-Neal II, which the proposal follows. However, to avoid placing state banks in the awkward position of not knowing whether a state law might otherwise be preempted for the activities of an out-of-state branch of a national bank, the final rule should include a mechanism to determine in a timely manner whether host state law is preempted in the absence of federal court ruling or written OCC determination.

The ICBA also believes steps are needed to place the activities of operating subsidiaries of state chartered banks on parity with the operating subsidiaries of national banks. Ultimately, this issue and other issues surrounding applicable law for national and state bank activities may have to be resolved by Congress. The ICBA encourages the FDIC to work with the industry and other banking regulators to develop a comprehensive plan to address the issues confronting the dual banking system in today's marketplace.

Thank you for the opportunity to comment. If you have any questions or would like additional information, please contact the undersigned or Robert Rowe by phone at 202-659-8111 or by e-mail at karen.thomas@icba.org or robert.rowe@icba.org.

Sincerely,

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