IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

WACHOVIA BANK, N.A. and WACHOVIA MORTGAGE CORPORATION, Plaintiffs, v. LINDA A. WATTERS, in her official capacity as Commissioner of the Michigan Office of Insurance and Financial Services, Defendant.	)	Civ. Act. No. 5:03-CV-0105 Hon. Robert Holmes Bell

BRIEF *AMICUS CURIAE* OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

The Office of the Comptroller of the Currency ("OCC") respectfully submits this brief *amicus curiae* in support of the plaintiffs' motion for summary judgment on their claims for declaratory and injunctive relief. As the federal regulator charged with overseeing the national banking system and administering the National Bank Act, the OCC has an institutional interest in ensuring that the requirements of federal law are observed and that plaintiffs are able to conduct their real estate lending activities to the full extent and in the manner authorized by federal law, subject to the plenary supervision of the OCC. Here, plaintiffs are entitled to exercise federally authorized powers to engage in real estate lending under the supervision of the OCC, notwithstanding the Michigan registration and supervisory regime administered by Defendant Watters, as Commissioner of the Michigan Office of Insurance and Financial Services (the

"Commissioner"). Federal law preempts the application of the Michigan statutes that purport to condition the exercise of those national bank powers and precludes the Commissioner's assertion of visitorial authority over a national bank operating subsidiary. Accordingly, plaintiffs are entitled to prevail on the preemption aspects of their motion for summary judgment.

OCC Supervisory Framework

The OCC is a bureau of the United States Treasury Department charged with the administration of the National Bank Act, 12 U.S.C. §§ 21 *et seq*., and oversight of the national banking system. The OCC has comprehensive authority over the chartering, supervision, and regulation of virtually every aspect of the operation of banks organized under the National Bank Act. Plaintiff Wachovia Bank, N.A. ("Wachovia" or the "Bank"), is a national bank chartered by the OCC pursuant to federal law that has received OCC authorization to conduct real estate lending activities through an operating subsidiary – plaintiff Wachovia Mortgage Corporation ("WMC"), a wholly-owned subsidiary of the Bank organized under the laws of North Carolina. Grimm Aff. ¶ 3. Under federal law, state and federal laws apply to WMC, as a national bank operating subsidiary, to the same extent as they apply to its parent national bank.

In its capacity as administrator of the national banking system, the OCC regularly conducts extensive examinations of the banking operations of national banks and their operating subsidiaries. These examinations evaluate the bank's compliance with principles of safe and sound banking and with any applicable laws concerning the bank's activities. 12 U.S.C. § 481. In addition, the OCC conducts targeted examinations that may focus on one or more elements covered by a comprehensive examination, such as compliance with specific laws. Federal law authorizes the OCC to inspect the bank's records and supervise its activities, including the

records and activities of any operating subsidiaries. The OCC evaluates the adequacy of all elements of the institution's business, including earnings, assets, management, liquidity, sensitivity to market risk, and information systems. Congress also has provided the OCC an extensive array of regulatory tools with which to address unsafe or unsound banking practices or violations of law by national banks. *See, e.g.,* 12 U.S.C. §§ 93 (forfeiture of charter, civil money penalties); 1818 (cease and desist orders, restitution; removal of officers and directors; civil money penalties). Through its supervisory, regulatory and enforcement authority, the OCC oversees the activities of national banks and their subsidiaries and takes action to maintain the sound operations of the national banking system.

National banks chartered by the OCC are statutorily authorized generally to engage in the business of banking and all activities incidental thereto. 12 U.S.C. § 24(Seventh). In addition, some national bank powers, including the authority to make, arrange, and deal in loans secured by interests in real estate, are specifically authorized by statute. 12 U.S.C. § 371. Under OCC regulations, national banks may engage in these activities by means of operating subsidiaries, subject to OCC licensure. 12 C.F.R. §§ 5.34; 34.1(b). Thus, federal law authorizes national banks to engage in a full range of real estate lending activities, both directly and through OCC-approved operating subsidiaries.

Longstanding case authority, crystallized in recently revised OCC regulations, makes clear that states are not at liberty to obstruct, impair, or condition the exercise of national bank powers, including those powers exercised through an operating subsidiary. 12 C.F.R. § 34.4(a)(1), (*published in* 69 Fed. Reg. 1917 (Jan. 13, 2004)(effective date February 12, 2004.)(*See* Addendum)) Additionally, and independently, the OCC has exclusive "visitorial" authority over

national banks and their operating subsidiaries except where federal law specifically provides otherwise. The term "visitorial" powers as used in 12 U.S.C. § 484 encompasses any examination, inspection of books and records, regulation or supervision of activities authorized or permitted pursuant to federal banking law, and enforcement of compliance with any applicable federal or state laws and with principles of safe and sound banking. 12 C.F.R. § 7.4000(a)(2). Under the OCC's regulations, an operating subsidiary is subject to the OCC's exclusive visitorial authority to the same extent as a national bank. 12 C.F.R. § 5.34(e)(3). When WMC became an operating subsidiary of the Bank on January 1, 2003, it therefore became subject to the exclusive visitorial authority of the OCC.

Michigan Statutory Conditions And Assertions of Authority.

Michigan law generally prohibits persons, including national bank operating subsidiaries (though not national banks), from acting as first and second mortgage lenders without first registering with the Commissioner on a prescribed form. Mich. Comp. Laws §§ 445.1652(5), 45.1656(1)(d); 493.52(1), 493.53a(d). Such lenders must also pay an annual fee. Mich Comp. Laws §§ 445.1658, 445.1657(1), 493.54. Among the powers vested in the Commissioner are the authority to "exercise general supervision and control" over mortgage lenders (Mich Comp. Laws §§ 445.1661 (1); 493.56b(1)); to conduct "examinations and investigations" (Mich Comp. Laws §§ 445.1661(2)(c) ; 493.56b(2)(b)); and to assess a civil fine (Mich Comp. Laws §§ 445.1661 (2)(i)); 493.56b(h)).

After WMC became an operating subsidiary of the Bank, it notified the Commissioner of its intention not to renew its mortgage registration with the Commissioner, but to continue to operate without registration in reliance on federal law. Plaintiffs' Motion for Summary

Judgment, Exhibit 1. The Commissioner's Office responded by letter, advising Wachovia that under Michigan law, it would not be authorized to conduct its mortgage lending business upon the cancellation of the registration. *Id.*, Exhibit 2.

ARGUMENT

FEDERAL LAW DISPLACES THE MICHIGAN REGISTRATION REGIME AS APPLIED TO NATIONAL BANK OPERATING SUBSIDIARIES

Federal law, both before and after the effective date of the recently revised OCC regulations, authorizes the Bank to conduct real estate lending activities through WMC, an OCC-authorized operating subsidiary, without complying with Michigan's registration and supervision regime. Federal law, both before and after the revisions' effective date, precludes the Commissioner from exercising visitorial powers over the Bank or WMC. Because the state statutory provisions that require registration and authorize the Commissioner to supervise and to take enforcement action against national bank operating subsidiaries conflict with national bank powers authorized by federal statute and regulation, the state restrictions are preempted by operation of the Supremacy Clause.[1/]

Accordingly, plaintiffs are entitled to summary judgment on their claim that federal law preempts the state statutes that purport to require WMC to register with the Commissioner as a condition of engaging in mortgage lending and that purport to authorize the Commissioner to supervise or take enforcement action against WMC. These conclusions are supported by

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[1/] Because the revisions will be effective on February 12, 2004, before the time the Court is scheduled to rule on the pending motions, it will be appropriate for the Court to rely upon the regulations as revised in making its rulings. We address the pre-revision state of the law in order to remove any doubt that the arguments already made by the Bank on the basis of pre-revision law remain sound.

longstanding federal caselaw, by OCC regulations -- including the recent revisions -- and by recent judicial decisions addressing the interaction of national bank operating subsidiaries and state law. *Wells Fargo Bank v. Boutris*, 252 F. Supp. 2d 1065 (E.D. Cal 2003) (summary judgment against state visitation of national bank operating subsidiary), *National City Bank of Indiana v. Boutris*, 2003 WL 21536818 (E.D. Cal. No. 03-655, July 2, 2003)(same, summary judgment), *consolidated for appeal,* (9th Cir., Nos. 0-3-16194, 03-16197, 01-16461)*; Budnik v. Bank of America Mortgage,* 2003 U.S. Dist. LEXIS 22542 (N.D. IL 2003) (national bank mortgage subsidiary to be treated like national bank for purposes of complete preemption).[2/]

I. FEDERAL LAW AUTHORIZES THE EXERCISE OF NATIONAL BANK POWERS BY MEANS OF AN OPERATING SUBSIDIARY SUBJECT TO THE SAME AUTHORITY, TERMS, AND CONDITIONS AS ITS PARENT NATIONAL BANK

Pursuant to their authority under 12 U.S.C. 24(Seventh), national banks have long used separately incorporated operating subsidiaries[3/] as a means of engaging in activities that the bank itself is authorized to conduct. The existence, function, and status of national bank operating subsidiaries was first formally recognized by the OCC in the mid-1960's, leading to the

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[2/] The Supreme Court has made it clear that it is appropriate for federal courts to defer to OCC's construction of the National Bank Act, explaining: "It our practice to defer to the reasonable judgments of agencies with regard to the meaning of ambiguous terms in statutes that they are charged with administering. * * * [T]hat practice extends to the judgments of the Comptroller of the Currency with regard to the meaning of the banking laws." *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 739 (1996) (internal quotes and citations omitted) (deferring to OCC regulation construing 12 U.S.C. § 85). Moreover, the Supreme Court has specifically identified OCC opinion letters as entitled to such deference, even when they are not preceded by notice and comment. *United States v. Mead Corp.*, 533 U.S. 218, 231 & n.13 (2001).

[3/] An "operating subsidiary" is defined to include entities in which a national bank has a controlling interest, but excludes subsidiaries that are specifically authorized by law, and subsidiaries acquired as satisfaction for a debt. 12 C.F.R. § 5.34(2).

promulgation in 1966 of a regulation that codified and regulated the authority of national banks to engage in activities through operating subsidiaries. *See* 31 Fed. Reg. 11,459 (Aug. 31, 1966) ("Operating Subsidiary Rule"). [4/]

Since their recognition in the 1960's, federal law has consistently recognized the functional identity of operating subsidiaries and their parent banks. Operating subsidiaries are consolidated with—that is, their assets and liabilities are indistinguishable from—the parent bank for accounting purposes, regulatory reporting purposes, and for purposes of applying many Federal statutory or regulatory limits.[5/] Courts have treated operating subsidiaries as equivalent to national banks in determining their powers and status under Federal law,[6/] except where

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[4/] The OCC addressed the authority of national banks to acquire or establish operating subsidiaries in interpretative letters that preceded the Rule. *See, e.g.,* Letter from Comptroller Saxon July 30, 1965 (unpublished) (authorizing Atlantic National Bank of Jacksonville, Florida to acquire the Atlantic Trust Company), summarized in National Banking Review, vol.3, no.2 at 268 (Dec. 1965). Comptroller Saxon concluded that the prohibition on stock ownership by national banks in 12 U.S.C. § 24(Seventh) does not apply "when such ownership is a proper incident to banking," as is the case with operating subsidiaries.

[5] *See, e.g.,* 12 C.F.R. 5.34(e)(4) (requiring application of, *e.g.,* statutory lending limit and limit on investment in bank premises to a national bank and its operating subsidiaries on a consolidated basis); 12 U.S.C. §371c(b)(2)(A); 12 C.F.R. §223.3(w) (exclusion of operating subsidiaries from restrictions on transactions with affiliate).

[6] *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.,* 513 U.S. 251 (1995) (sale of annuities by operating subsidiary); *Clarke v. Securities Industry Ass'n*, 479 U.S. 388 (1987) (securities brokerage operating subsidiary); *American Ins. Ass'n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988) (bond insurance subsidiary); *M & M Leasing Corp. v. Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978)(auto leasing subsidiary); and *Valley Nat'l Bank v. Lavecchia*, 59 F. Supp. 2d 432 (D. N.J. 1999) (title insurance subsidiary); *Budnik v. Bank of America Mortgage,* 2003 U.S. Dist. LEXIS 22542 (N.D. IL 2003) (mortgage subsidiary).

Federal law requires otherwise.[7/] The recognition of such subsidiaries is not unique to national banks or to the OCC, but rather, is a concept shared with other federal banking agencies, including the Federal Reserve Board[8/] and the Office of Thrift Supervision ("OTS").[9/]

The current version of the Operating Subsidiary Rule provides that "[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." 12 C.F.R. § 5.34(e)(1). The Rule specifies the licensing process through which national banks seek OCC permission to conduct business by means of an operating subsidiary. 12 C.F.R. § 5.34(b).[10/] The Rule makes clear that in

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[7/] *See, e.g., Minnesota v. Fleet Mortgage Corp.*, 181 F. Supp. 2d 995 (D. Minn. 2001) (distinguishing banks and subsidiaries for purposes of the Federal Trade Commission Act under terms of 15 U.S.C. § 41 note).

[8/] In a 1968 interpretation, the Federal Reserve concluded that banks that are members of the Federal Reserve System may own operating subsidiaries: "[T]he incidental powers clause permits a bank to organize its operations in the manner that it believes best facilitates the performance thereof. One method of organization is through departments; another is through separate incorporation of particular operations. In other words, a wholly owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement." 12 C.F.R. § 250.141(c). *See also* 12 C.F.R.223.3(w)("operating subsidiary of a member bank is treated as part of the member bank;") 12 C.F.R. § 225(e)(2)(authorizing member banks to own operating subsidiaries without Board approval); *Citicorp v. Board of Governors of the Federal Reserve System*, 936 F. 2d 66 (2nd Cir. 1991), *cert. denied*, 502 U.S.1031 (1992)(denying textual argument for disparate treatment of banks and operating subsidiaries under the Bank Holding Company Act).

[9/] A regulation of the Office of Thrift Supervision ("OTS") specifies that state law applies to thrift operating subsidiaries only to the same extent as it applies to the parent thrift. 12 C.F.R. § 559.3(n).

[10/] The licensing procedures require a national bank to file an application with the OCC and receive OCC approval to acquire or establish the operating subsidiary. 12 C.F.R. § 5.34(e)(5)(i). An adequately or well capitalized national bank, as defined in OCC regulations, need not file a new notice, however, if the OCC has already permitted the bank to carry out the same activity in a prior

conducting permissible activities on behalf of its parent bank, the operating subsidiary is acting "pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank." 12 C.F.R. § 5.34(e)(3). This text echoes a Congressional characterization in recent legislation, where Congress made reference to national bank operating subsidiaries as engaged "solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks." Section 121 of the Gramm-Leach-Blilely Act, Pub. L. 106-102, section 121, 113 Stat. 1338, 1373 (1999), codified at 12 U.S.C. 24a(g)(3)(A).

On the basis of federal statute and OCC regulations, therefore, when established in accordance with OCC regulations and approved by the OCC, an operating subsidiary is a Federally-authorized and Federally-licensed means by which a national bank may conduct Federally-authorized activities. Furthermore, as a matter of Federal law, operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent bank. 12 C.F.R. 5.34(e)(3). As a corollary, operating subsidiaries are, like their parent banks, subject to the visitorial authority of the OCC, exclusive of any other visitorial authority, except as provided by federal law. 12 C.F.R. § 7.4006.

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operating subsidiary application. 12 C.F.R. § 5.34(e)(5)(vi). In addition, a well-capitalized and well-managed bank may obtain OCC approval to engage in certain activities specified by regulation by providing notice to the OCC within ten days of establishing or acquiring the operating subsidiary. 12 C.F.R. § 5.34(e)(5)(iv).

II. FEDERAL LAW PRECLUDES MICHIGAN FROM IMPOSING CONDITIONS ON PLAINTIFFS' EXERCISE OF FEDERALLY AUTHORIZED POWERS TO ENGAGE IN REAL ESTATE LENDING ACTIVITIES THROUGH AN OPERATING SUBSIDIARY

Because Michigan's application of its mortgage lender registration regime to national bank operating subsidiaries purports to impose conditions on the exercise of national bank powers, those statutory provisions are preempted, as applied, by operation of the Supremacy Clause. This conclusion is based upon statutory, regulatory, and judicial authority, including the recent revisions to OCC regulations.

Under the Constitution's Supremacy Clause, when the federal government acts within the sphere of its authority, federal law is paramount over, and preempts, inconsistent state law. *See, e.g., McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819); *Bank of America v. City and County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 123 S. Ct. 2220 (2003). The nature and degree of conflict between state and federal law that will trigger preemption has been expressed in a variety of formulations,[11/] recently summarized by the Ninth Circuit: "State attempts to control the conduct of national banks are void if they conflict with federal law, frustrate the purposes of the National Bank Act, or impair the efficiency of national banks to discharge their duties." *Bank of America*, 309 F. 3d at 561. *See Barnett Bank v. Nelson*, 517 U.S. 25, 31 (1996), *quoting Hines v. Davidowitz,* 312 U.S. 52, 67 (1941)(state law preempted where it may "stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.").

[11/] "This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference." *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941).

Those principles have repeatedly been applied to invalidate state authority that would obstruct the exercise of national bank powers, including national banks' use of business tools.[12/] In *Franklin Nat'l Bank of Franklin Square v. New York*, 347 U.S. 373 (1954), the Court held that the national bank power to receive savings deposits preempted a state statute that prohibited national banks from using the word "savings" in their advertising. The Court noted that: "Modern competition for business finds advertising one of the most usual and useful of weapons. * * * It would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it." *Franklin*, 347 U.S. at 377-78; *see also American Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000 (E.D.Cal. 2002)(state statute requiring credit card lenders to make voluminous warnings to borrowers preempted because of burden upon national banks' use of credit card statements.) The Court has observed that the history of Supremacy Clause litigation of national bank authority is "one of interpreting grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law." *Barnett*, 517 U.S. at 27.[13/]

[12/] *See, e.g., Farmers' & Merchants' Nat'l Bank v. Dearing*, 91 U.S. 29, 33-35 (1875); *First Nat'l Bank of Logan v. Walker Bank & Trust Co.*, 385 U.S. 252, 256 (1966) (observing that "[t]he paramount power of the Congress over national banks has * * * been settled for almost a century and a half"). *See generally Barnett* (federal statute preempts state statute restricting bank sales of insurance); *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896).

[13/] It is immaterial to the application of this principle whether the federal power is explicit or implicit in the National Bank Act. *Barnett,* 517 U.S. at 31; *see Franklin Nat'l Bank v. New York,* 347 U.S. at 375-79 & n.7. In any event, as discussed above, the power to engage in real estate lending at issue here is explicitly authorized by the National Bank Act. 12 U.S.C. § 371.

The Supreme Court in *Barnett* also indicated that state attempts to impose conditions upon the exercise of national bank powers constitute obstacles giving rise to preemption unless authorized by federal law. "[W]here Congress has not expressly conditioned the grant of 'power' upon a grant of state permission, the Court has ordinarily found that no such condition applies." 517 U.S. at 34, *citing Franklin*, 347 U.S. at 377-78 (1954)(preempting state restriction on national bank advertising). This principle has repeatedly been applied to defeat attempts by states to impose conditions upon the exercise of national bank powers. *See, e.g., Association of Banks in Insurance, Inc. v. Duryee,* 55 F. Supp. 2d 799, 812 (S.D. Ohio 1999), *aff'd,* 270 F.3d 397 (6th Cir. 2001) (even the most limited aspects of state licensing requirements such as the payment of a licensing fee are preempted because they "constitute impermissible conditions upon the authority of a national bank to do business within the state"); *Bank One* v. *Guttau,* 190 F.3d 844 (8th Cir. 1999), *cert. denied*, 529 U.S. 1087 (2000)(state registration regime and other restrictions on national bank deployment of ATMs preempted by National Bank Act.); *First Nat'l Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775, 780 (8th Cir.1990), *cert. denied*, 498 U.S. 972 (1980) (National Bank Act precludes state regulator from prohibiting a national bank, through either enforcement action or a license requirement, from conducting authorized activity).[14/]

[14/] The OCC also has opined previously that state laws purporting to require the licensing of activities authorized for national banks under federal law are preempted. *See, e.g.,* OCC Interpr. Ltr. No. 749 (Sept. 13, 1996) *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,114 (state law requiring national banks to be licensed by the state to sell annuities would be preempted); OCC Interpr. Ltr. No. 644 (March 24, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,553 (state registration and fee requirements imposed on mortgage lenders would be preempted). The revised regulations make clear that registration for the purpose of service of process is generally not preempted. 12 C.F.R. § 34.4(a)(1), *published in* 69 Fed. Reg. 1917 (*See* Addendum.)

The conduct of real estate lending activities through an operating subsidiary is generally and expressly authorized by 12 C.F.R. § 34.1(b). When a national bank acquires or establishes an operating subsidiary through which the bank will conduct bank-permissible activities, it does so pursuant to an approval from the OCC specific to its circumstances under 12 C.F.R. § 5.34. Accordingly, WMC's status as an operating subsidiary means that the Bank has received approval to use WMC in the conduct of its mortgage lending business. Just as the *Franklin* Court ruled that New York could not deny national banks the "useful" commercial tool of advertising, Michigan cannot impose conditions on the Bank's use of the federally approved medium represented by WMC. Furthermore, because Section 7.4006 provides that state laws apply to WMC only to the same extent that they apply to the Bank, the state registration requirements that act as a condition may not be applied to WMC, just as they may not be applied to the Bank. 12 C.F.R. § 7.4006. Accordingly, Michigan statutes that purport to apply Michigan registration requirements to the real estate lending activities of the Bank conducted through WMC conflict with federal law and are therefore nullified, as applied, by the Supremacy Clause of the United States Constitution.

Recent revisions to OCC regulations state these conclusions expressly, summarizing the import of the OCC's regulations and the caselaw: "Except where made applicable by Federal Law, state laws that obstruct, impair, or **condition** a national bank's ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks. Specifically, a national bank may make real estate loans * * * without regard to state law limitations concerning: (1) Licensing, **registration**, (except for purposes of service of process), filings * * *." 12 C.F.R. § 34.4(a), (1), *published in* 69 Fed. Reg. 1917 (Jan. 13, 2004)(effective February

12, 2004)(emphasis added)(See Addendum). The Michigan statutory provisions at issue expressly "condition" the exercise of national bank first and second mortgage real estate powers exercised through WMC. Furthermore, there is an inescapable conflict between the federal regulation permitting WMC to exercise those powers without registering (other than for service of process) or making filings, and the Michigan statutes that purport to impose those requirements. Accordingly, because the state restrictions conflict with federal authority embodied in statutes and regulations, the state statutory provisions are preempted as applied to the plaintiffs and to other national banks and their operating subsidiaries.

III. FEDERAL LAW PRECLUDES MICHIGAN'S ASSERTIONS OF VISITORIAL AUTHORITY OVER WMC.

A. Exclusive Visitorial Power Over National Banks Is Vested In The OCC Unless Federal Law Directs Otherwise

The National Bank Act prescribes that the OCC's visitorial authority over national bank operations is exclusive:

> 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 or by either House thereof or by any committee of Congress or of either House duly authorized.

12 U.S.C. § 484; *see First Union Nat'l Bank v. Burke*, 48 F. Supp. 2d 132, 143-146 (D. Conn. 1999)(applying section 484 to preclude Connecticut assertion of administrative authority over national banks). Section 484 applies to national bank operating subsidiaries to the same extent as it applies to the parent national bank. 12 C.F.R. § 7.4006. The Michigan statutory provisions that reserve to the Commissioner registration, supervision, and enforcement authority over WMC are therefore in conflict with federal statute and regulations.

Section 484, which was part of the National Bank Act enacted in 1864, is integral to the design and structure of the national banking system and reflects the fundamental intentions of Congress in creating the national bank system. An essential objective of Congress in authorizing the creation of national banks was the formation of a national banking system that would operate under distinct standards set by federal law, separate from the existing system of state banks. At the time the National Bank Act was being considered, both proponents and opponents of the creation of a national banking system expected that the legislation would reduce state control over banking and eventually replace the existing system of state banks.[15/] Given the widely held views of the expected effect of the new national banking legislation on state banks, proponents of the National Bank Act were concerned that the states would attempt to undermine the national banking system through hostile regulation aimed at national banks, and took care to forestall that threat. The Supreme Court recently observed, with respect to one such precaution, the exclusive federal remedy for usury claims against national banks: "[T]his Court has * * * recognized the special nature of federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system

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[15/] Representative Samuel Hooper, who reported the bill to the House, stated in support of the legislation that one of its purposes was "to render the law so perfect that the State banks may be induced to organize under it, in preference to continuing under their State charters." Cong. Globe, 38th Cong. 1st Sess. 1256 (March 23, 1864). Opponents of the legislation believed that it was intended to "take from the States . . . all authority whatsoever over their own State banks, and to vest that authority . . . in Washington . . . ." Cong. Globe, 38th Cong., 1st Sess. 1267 (March 24, 1864) (statement of Rep. Brooks). *See also* statement of Rep. Pruyn (stating that the legislation would "be the greatest blow yet inflicted upon the States . . . .") Cong. Globe, 38th Cong., 1st Sess. 1271 (March 24, 1864); statement of Sen. Sumner ("Clearly, the [national] bank must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions.") Cong. Globe, 38th Cong., 1st Sess., at 1893 (April 27, 1864).

that needed protection from 'possible unfriendly State legislation.'" *Beneficial Nat'l Bank v. Anderson*, 123 S.Ct. 2058, 2064 (2003), *quoting Tiffany v. National Bank of Mo.*, 18 Wall 409, 412 (1874) (upholding removal jurisdiction over state law usury claims against national banks).

The same concerns about hostile state interests animated the National Bank Act's reservation to the OCC of visitorial powers over national banks. Just as Congress acted to preclude the use of usury laws as a tool against national banks, it acted through section 484 to forbid the more direct exercise of power by states by the assertion of visitorial authority. Instead, Congress established a separate federal regulatory regime to govern national banks and created the OCC to implement it. To preserve the uniform standards and uniform system of regulation applicable to national banks, and to protect them from potentially disruptive actions by the states, Congress vested in the OCC exclusive visitorial authority over these new federal instrumentalities.

In *Guthrie v. Harkness*, 199 U.S. 148 (1905), the Supreme Court explained the importance of the OCC's exclusive visitorial powers to furthering the objectives of Congress as follows:

> Congress had in mind, in passing [12 U.S.C. § 484] that in other sections of the law it had made full and complete provision for investigation by the Comptroller of the Currency and examiners appointed by him, and, authorizing the appointment of a receiver, to take possession of the business with a view to winding up the affairs of the bank. It was the intention that this statute should contain a full code of provisions upon the subject, and that no state law or enactment should undertake to exercise the right of visitation over a national corporation. Except in so far as such corporation was liable to control in the courts of justice, this act was to be the full measure of visitorial power.

Id. at 159. *See also Dietrich v. Greaney*, 309 U.S. 190, 194 (1940) ("The National Bank Act constitutes 'by itself a complete system for the establishment and government of National Banks.'") *quoting Cook County Nat'l Bank v. United States*, 107 U.S. 445, 448 (1883)). The Supreme Court has consistently acknowledged that Congress intended to limit the authority of states over national banks precisely so that the nationwide system of banking created by the National Bank Act could flourish. For example, in *Easton v. Iowa*, 188 U.S. 220 (1903) the Supreme Court explained:

> [Federal legislation concerning national banks] has in view the erection of a system extending throughout the country, and independent, so far as the powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the states. * * * It thus appears that Congress has provided a symmetrical and complete scheme for the banks to be organized under the provisions of the statute. * * * [W]e are unable to perceive that Congress intended to leave the field open for the states to attempt to promote the welfare and stability of national banks by direct legislation. If they had such power it would have to be exercised and limited by their own discretion, and confusion would necessarily result from control possessed and exercised by two independent authorities.

Id. at 229, 231-232.

The scope of "visitorial" powers is expansive, including any act of the superintending official to inspect, regulate, or control the operations of a bank to enforce the bank's observance of the law. *First Nat'l Bank of Youngstown v. Hughes*, 6 F. 737, 740 (6th Cir. 1881), *appeal dismissed*, 106 U.S. 523 (1883); *see also Peoples Bank of Danville v. Williams*, 449 F. Supp. 254 (W.D. Va. 1978) (visitorial powers involve the exercise of the right of inspection, superintendence, direction, or regulation over a bank's affairs). In *Guthrie*, the Supreme Court

confirmed the broad meaning of the term "visitorial" as used in section 484, explaining that English common law used the term "visitation" to refer to the authority exercised by a superintending officer who visits a corporation to examine its manner of conducting business and enforce observance of the laws and regulations. *Guthrie* 199 U.S. at 158 (*citing First Nat'l Bank of Youngstown v. Hughes*, 6 F. at 740). "Visitors" of corporations "have power to keep them within the legitimate sphere of their operations, and to correct all abuses of authority, and to nullify all irregular proceedings." *Id.* (citations omitted).

As the agency charged with administration of the National Bank Act, the OCC has promulgated a regulation regarding the exercise of visitorial powers over national banks:

> Only the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks, except as provided in paragraph (b) of this section. State officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances authorized by federal law. * * * .

12 C.F.R. § 7.4000(a)(1).[16/] The regulation explains that the exercise of visitorial powers over a national bank includes: (i) examination of the bank; (ii) inspection of the bank's books and records; (iii) regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) enforcing compliance with any applicable federal or state laws concerning

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[16/] The OCC's recent revisions to this regulation do not materially affect its application in this case. The preamble to the revisions emphasizes that "state laws purportedly forming the basis for the exercise of state regulatory or supervisory authority over national bank operating subsidiaries, which are inapplicable to the parent national bank, are similarly inapplicable to the bank's operating subsidiary." 69 Fed. Reg. 1901 (Jan. 13, 2004).

banking-related activities. 12 C.F.R. § 7.4000(a)(2).[17/] *See also* OCC Advisory Letter 2002-9 (Nov. 25, 2002) ("AL 2002-9")(explaining effect of section 484).

Section 484 establishes the OCC as the exclusive regulator of the banking operations of national banks, irrespective of the form that the regulatory action takes, and irrespective of whether the activities involve state[18/] or federal law, except where federal law specifically provides otherwise. Congress affirmed a specific instance of these exclusive visitorial powers in the Riegle-Neal Interstate Banking Act of 1994 ("Riegle-Neal"), Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994). Under Riegle-Neal, interstate branches of national banks are subject to particular laws of a "host" state in which the bank has an interstate branch to the same extent as a branch of a state bank of that state, *except* when the application of such state laws to national banks is preempted. 12 U.S.C. § 36(f)(1)(A). But, even in those cases where state law is applicable to national banks, the statute specifies that authority to enforce the law is then vested in the OCC: "The provisions of any State law to which a branch of a national bank is subject under this paragraph shall be enforced, with respect to such branch, by the Comptroller of the Currency." 12 U.S.C. § 36(f)(1)(B)

[17/] The regulation also addresses some of the statutory exceptions to the OCC's exclusive visitorial authority. The regulation addresses: obtaining information about shareholders (12 U.S.C. § 62); ensuring compliance with state unclaimed property laws (12 U.S.C. § 484(b)); verifying payroll records for purposes of unemployment compensation (26 U.S.C. § 3305(c)); ascertaining the correctness of federal tax returns (26 U.S.C. § 7602); and enforcing the Fair Labor Standards Act (29 U.S.C. § 211). 12 C.F.R. § 7.4000(b).

[18/] Visitorial power over national banks resides solely in the OCC even when the subject is state law that touches upon the banking operations of a national bank. *See National State Bank, Elizabeth, N.J. v. Long,* 630 F.2d 981, 989 (3d Cir. 1980) ("[E]nforcement of the state statute is the responsibility of the Comptroller of the Currency rather than the State Commissioner.").

Based on express statutory text, OCC regulations, and judicial precedents it is clear that the Commissioner has no authority to exercise any visitorial powers over the activities of national banks.

B. The OCC's Exclusive Visitorial Authority Extends to Activities Conducted By National Banks Through Their Operating Subsidiaries

As described above, when established in accordance with the procedures mandated by the OCC Operating Subsidiary Rule and approved by the OCC, the operating subsidiary is a federally-authorized means by which a national bank may conduct federally-authorized activities. Recognizing this status, courts have consistently treated the operating subsidiary and the national bank as equivalents, unless federal law requires otherwise, in considering whether a particular activity was permissible for a national bank. *See*, *e.g.*, *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Company*, 513 U.S. 251 (1995) (sale of annuities by operating subsidiary); *Clarke v. Securities Industry Ass'n*, 479 U.S. 388 (1987) (securities brokerage operating subsidiaries); *American Insurance Ass'n, v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988) (bond insurance subsidiary); *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977) (auto leasing subsidiary); *Valley National Bank v. Lavecchia*, 59 F.Supp.2d 432 (D. N.J. 1999) (title insurance subsidiary).

In accordance with this longstanding regulatory and judicial recognition of operating subsidiaries as corporate extensions of the parent bank, OCC regulations specifically address the application of the state law to national bank operating subsidiaries. That regulation provides:

> 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 parent national bank.

12 C.F.R. § 7.4006; *see also* 12 C.F.R. §§ 34.1(b); 34.4(b) (authorizing national bank operating subsidiaries to conduct real estate lending operations). A federal district court in California has recently upheld section 7.4006 against challenge, stating that: "It is plain that the [National Bank] Act delegated the OCC the authority to promulgate § 7.4006 and § 7.4006 reflects a reasonable construction of the Act." *Wells Fargo Bank v. Boutris*, *supra*, 265 F. Supp 2d at 1169; *National City Bank of Indiana v. Boutris*, *supra*, 2003 WL 21536818 at *6-7 (same).

Because 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 OCC-authorized conduct of those activities through an operating subsidiary, absent federal law dictating a contrary result.[19/] *See Wells Fargo,* 265 F. Supp. 2d at 1170 (Commissioner of California Department of Corporations has no visitorial powers over national bank mortgage operating subsidiary); *National City Bank of Indiana at *6-7*(same).[20/]

C. The Michigan Statutory Assertion of Visitorial Authority Over WMC Conflicts with Federal Law and Is Preempted

Because there is a direct conflict between federal law and the Michigan statutory provisions providing for registration, supervision, and enforcement authority over national bank

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[19/] *See, e.g., Minnesota v. Fleet Mortgage Corp.*, 181 F.Supp.2d 995 (D. Minn. 2001).

[20/] This conclusion is consistent with the results reached under the OTS regulation that provides that state law applies to Federal savings associations' operating subsidiaries only to the extent that the law applies to the parent thrift. The regulation has been upheld by both federal and state courts. *See WFS Financial Inc. v. Dean*, 79 F. Supp. 2d 1024 (W.D. Wis. 1999); *see also Chaires v. Chevy Chase Bank, F.S.B.*, 748 A.2d 34, 44 (Md. App. 2000).

operating subsidiaries, those state provisions are preempted by operation of the Supremacy Clause.

Pursuant to its explicit rulemaking authority under the National Bank Act, 12 U.S.C. § 93 and authority to establish conditions for real estate lending under 12 U.S.C. § 371, and in accordance with notice and comment procedures under the Administrative Procedure Act, 5 U.S.C. § 553, the OCC has issued rules that address: (1) the scope of visitorial powers under section 484, 12 C.F.R. § 7.4000; (2) the authority of national banks to engage in activities through separately incorporated operating subsidiaries, 12 C.F.R. § 5.34, specifically including real estate lending activities, 12 C.F.R. § 34.1(b); and (3) the application of state law to national bank operating subsidiaries, 12 C.F.R. § 7.4006. These "[f]ederal regulations have no less pre-emptive effect than federal statutes." *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 153 (1982).[21/] Congress has made plaintiffs subject to the regulatory and enforcement authority of the OCC and has explicitly reserved to OCC alone the authority to exercise any form of visitorial power over plaintiffs absent specific authorization by federal law for another federal (or state) regulator to act. Under these circumstances, federal law displaces the Michigan statutes that purport to give the Commissioner authority to visit WMC and other national bank operating

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[21/] In addition, the OCC has construed the National Bank Act in opinion letters that OCC has issued specifically addressing the application of section 484 to national bank operating subsidiaries. *See, e.g.,* Interpretive Letter #957 (January 27, 2003, from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, to Scott A. Cammarn, Esq., Associate General Counsel, Bank of America)**;** Letter dated February 11, 2003, from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, to Demetrios A. Boutris, Commissioner, California Department of Corporations**;** Letter dated January 16, 2003, from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, to Reginald S. Evans, Chief Counsel, Pennsylvania Department of Banking**;** *see also* OCC Advisory Letter 2002-9 (November 25, 2002).

subsidiaries by means of registration as a condition of doing business, supervision, and enforcement.

IV. THE MICHIGAN REGIME DERIVES NO SUPPORT FROM THE TENTH AMENDMENT

There is no basis for the Commissioner's assertion of the 10th Amendment as an affirmative defense. Answer, at 9, ¶ 1. *See Wells Fargo*, 265 F. Supp. 2d at 1170-71 (rejecting 10th Amendment challenge to OCC's visitorial authority). Where federal authority is exercised pursuant to Congress's Article I powers, including the Commerce Clause, that authority has not been reserved to the states, as contemplated by the 10th Amendment. *See, e.g., United States v. Lopez*, 514 U.S. 549 (1995). The establishment and regulation of the national banking system is squarely within Congress's powers under the Commerce Clause. "No elaborate explanation is needed to make evident the broad impact of commercial lending on the national economy or Congress' power to regulate that activity pursuant to the Commerce Clause." *Citizens Bank v. Alafabco Inc*. 123 S. Ct. 2307, 2040 (2003). Accordingly, the 10th Amendment does not insulate the Michigan statutes against preemption.

CONCLUSION

For the reasons set forth above, the Michigan statutes that make up its mortgage lending registration, supervision, and enforcement regime are contrary to federal law, and preempted as applied. to national banks and their operating subsidiaries. Accordingly, on the basis of the undisputed facts, plaintiffs are entitled to judgment as a matter of law.

Respectfully submitted,

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