Remarks by
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It is really a pleasure to see the New York Bankers again in Washington.

Thank you for inviting me again to meet with you. I guess this means I haven't worn out my welcome. I'll try to make sure that never happens.

When I've met with this group in previous years, I have spoken about important industry and policy developments with notable legal components – and you've still invited me back….

I hope I'm not pushing my luck, but I'm going to do that again, and offer some observations on the Supreme Court's decision in *Watters v. Wachovia Bank*, and some thoughts on the implications of *Watters* for the future.

First, by way of background, what was this case all about? For all of the sometimes apocalyptic rhetoric surrounding it, the precise issue presented was whether activities conducted by an operating subsidiary of a national bank are subject to state laws to the same extent as when those same activities are conducted directly by the parent national bank. In other words, if a state law is preempted and may not be applied to an activity conducted by a national bank, is the state law preempted if the bank chooses to conduct the activity through an operating subsidiary of the bank?

The OCC argued that an operating subsidiary is a federally-authorized means through which a national bank exercises powers authorized under federal law and that the exercise of those powers through the structural option of an operating subsidiary should not be treated any differently than if the powers were exercised directly by the bank. Ultimately, after years of litigation in federal district courts and federal courts of appeal, the Supreme Court agreed.

The decision itself is interesting in several respects – and not just for hard core preemption aficionados. But more important now is how *Watters* sets the stage for the roles and responsibilities of federal and state regulators going forward.

The decision is steeped in the history of the national banking system and its conclusions are repeatedly anchored to Supreme Court precedent finding preemption of state laws under the National Bank Act where those laws conflict with a national bank's powers. In particular, citing a number of these previous decisions, the Court reaffirmed the key principle from its *Barnett* decision of over a decade ago – that state law may not significantly burden, curtail, or hinder a national bank's efficient exercise of any of its banking powers established by Congress under the National Bank Act.

The opinion expressly recognizes duplicative state examination, supervision and regulation as significant burdens triggering preemption, but it also recognizes – again citing multiple Supreme Court precedents – that national banks are subject to state laws of general application to their daily business, if they do not conflict with the provisions or purposes of the National Bank Act. In others words, the principles upon which the decision is based are not groundbreaking.

For this reason, it is our view that the *Watters* decision does not mark a shift in the state of the law. What the decision does do, however, is to provide certainty about the roles of federal and state regulators, and specifically, that the banking business conducted by national banks under powers granted to them by federal law, whether conducted by the bank directly or through the bank's operating subsidiary, is, with limited exception, subject to the OCC's exclusive supervisory authority, and not to state regimes.

In this important regard, the *Watters* decision clarifies accountability. In fact, the decision opens with a broad description of the responsibilities of the OCC – not just the fiscal safety and soundness of national banks, but "oversee[ing] the operations of national banks and their interactions with the customers." We keenly recognize both responsibilities, and we expect to be held accountable for how well we carry them out.

At the OCC, we are committed to the financial and operational safety and soundness of national banks *and* to ensuring strong protections for national bank consumers. These components of our mission are consistent and complementary. With regard to the consumer protection component, we have devoted substantial resources toward assuring strong standards are in place and sound practices prevail

As Comptroller Dugan recently testified before Congress, the cornerstone of our consumer protection approach is comprehensive, ongoing supervision of national banks and their operating subsidiaries. We extensively examine national banks to ensure that they are operating in a safe and sound manner and in accordance with applicable laws, regulations, and supervisory directives – including those relating to consumer protection. We supervise national banks by business line, not according to corporate form, so the standards we apply in the course of our supervision are the same for national banks and their operating subsidiaries.

We recognize that retail banking supervision, including its consumer protection component, is a complex enterprise and that effective supervision of retail banking activities today requires a sophisticated assessment of the bank's policies, operations, and controls, and of the long-term effect of those policies, operations, and controls on the bank's reputation, customer relationships, legal exposure, and earnings. Our supervisory activities bring to bear a wide range of the expertise of OCC staff, including not only consumer compliance specialists, lawyers, and economists, but also examiners with retail credit risk, credit card, and mortgage banking backgrounds.

We use a risk-based continuous supervisory process for all national banks. In the course of our ongoing supervision, our examiners review the adequacy of a bank's policies, systems, and controls relative to the character and complexity of the bank's business, and evaluate whether the bank's activities are being carried out in compliance with applicable consumer protection laws and regulations. Examiners typically sample individual loans or other transactions to validate their assessment of the bank's systems, controls, and legal compliance, and, depending on the bank's risk profile and other supervisory information, including consumer complaints, examiners may target their reviews to a particular loan product, business line, or operating unit.

Communication is ongoing and includes formal and informal meetings as well as Reports of Examinations and other written material. The written materials detail findings from our ongoing supervision and target reviews. Violations of law or regulation, non-conformity with supervisory guidance, and other significant problems typically are detailed as "Matters Requiring Attention" (MRA). Examiners obtain management's commitment to correct these deficiencies and track these MRAs until resolution. OCC examiners expect MRAs to be corrected promptly, and without further action by the OCC – any failure by bank management to do so would contribute to a conclusion that formal steps are required.

The supervisory process can be especially effective in addressing problems early, before they become more widespread – indeed, in many instances, banks consult with OCC examiners about their plans before implementing them, so that any issues can be raised and addressed *before* the bank makes a wrong turn. Examiners often are able to address potential consumer protection and safety and soundness issues proactively with management through this ongoing supervision process.

This scope and depth of how we supervise national banks' operations and interactions with their customers is probably not well understood by many outside the banking industry. Because bank supervision involves confidential communications with regulated institutions, and much of the problem identification and corrective action occurs behind the scenes and without public fanfare, the effectiveness of the process is not fully appreciated.

Bank supervision applied to consumer protection concerns also is different from more familiar – and more publicized – regulatory regimes in which agencies typically resort to formal litigation or enforcement proceedings to redress consumer problems, effect desired changes and impose sanctions. Bank supervision does not rely principally on enforcement actions to achieve corrections and remediation. As the Supreme Court recognized over 40 years ago in the *Philadelphia Nat'l Bank* case, "recommendations by the [federal bank supervisory] agencies concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings."

Nevertheless, the OCC does not hesitate to bring an enforcement action when appropriate, but in practice, the need to do so is relatively infrequent. Banks typically agree to changes and remediation recommended by examiners, including financial relief to be provided to customers.

This comprehensive approach – the standards that we apply, and the resources we employ – reflect our commitment to carrying out the full range of responsibilities identified by the Supreme Court in *Watters* – "overseeing the operations of national banks and their interactions with their customers."

But *Watters* clarifies accountability in another dimension as well: Both federal *and state* regulators have jobs to do. And the subprime mortgage concerns we confront today illustrate this point well. The abuses in the subprime lending business – loan flipping, equity stripping, and making subprime loans that borrowers have no realistic prospect of repaying – have not sprouted and spread in the national banking system.

Hard data show that the quality of the subprime loans that are made by national banks is markedly better than those of other lenders – the delinquency rate has run about half the national average. We don't think this is an accident – it is a reflection of the quality of our supervision and our supervisory standards.

Further, hard data also show that most subprime lending is done by non-bank entities regulated by state authorities. These lenders clearly are – and always have been – subject to the oversight and enforcement jurisdiction of state officials. The *Watters* decision does not limit their ability to prevent these lenders from engaging in abusive practices or making loans that borrowers have no reasonable prospect of repaying.

And that brings us to how *Watters* points to a path for the future. Clearly, both the OCC and the states have jobs to do, and more consumers benefit when the OCC and the states do a good job covering our respective areas of responsibility, rather than duplicating each other's efforts, and when we find ways to collaborate and share information where that makes the most sense.

Despite our past differences, federal and state regulators need to move on – and we *are* moving on – to a new paradigm of cooperation and collaboration that optimizes use of our respective resources and maximizes consumer protection benefits for customers.

We have made significant progress, for example, working with our state counterparts to improve consumer complaint information sharing. The model Memorandum of Understanding agreed to by the OCC and the CSBS last year provides that we and state regulators will refer misdirected complaints to the appropriate agency. It also establishes a mechanism for state agencies to obtain – without compromising consumer privacy – periodic reports from the OCC on the disposition of complaints they have referred to the OCC's Customer Assistance Group. I am happy to point out that New York was the first state to enter into this new agreement with the OCC.

With the assistance of the CSBS, we are in the process of entering into complaint information sharing agreements with additional individual states, and the process is moving along very well – we have executed 19 such agreements since November, and others are on the horizon.

We also are developing a new system, the Complaint Referral Express, which is a new technology platform that we hope will provide, in 2008, a more automated application to facilitate the transfer of misdirected complaints and referrals between the OCC and other federal and state banking agencies.

I am also very pleased to report that the OCC has just launched a new internet site called www.helpwithmybank.gov. It is widely recognized that customers of financial institutions may not know which federal or state agency regulates their institution, or how to file a complaint or otherwise obtain assistance when they have a problem. We believe the new website – developed and funded by the OCC – will help address those issues. The site will include a wide variety of frequently-asked questions and answers; a reference tool that will assist consumers in determining which agency regulates their institution; and information on how to contact the various federal and state bank regulatory agencies.

But we can do more to make this process even easier for consumers. This is why Comptroller Dugan stressed in his recent Congressional testimony that the OCC supports the development of a true "one stop" approach for consumer assistance developed jointly by federal and state banking regulators.

In the area of supervisory guidance, the OCC, the other federal regulators and state regulators have worked constructively in connection with the nontraditional mortgage guidance and the subprime mortgage guidance just issued by the federal banking agencies. However, the guidance issued by the federal banking agencies extends only to the institutions that are supervised by federal regulators.

Yet, as I have noted above, most subprime lending is done by non-bank lenders regulated by the states. So, it is critical that all states not just adopt but also effectively *apply* standards comparable to those adopted and applied by the federal banking agencies.

We are encouraged that 35 states have adopted or endorsed policies and regulations similar to the federal nontraditional mortgage guidance, and that a similar push is underway with respect to the subprime mortgage guidance recently adopted by the federal banking agencies. We applaud these efforts, led by the CSBS. It bears repeating, however, that neither type of guidance can be fully effective until it is adopted and actually <u>applied</u> by all states, not as a suggestion, but as an expectation with consequences attached.

We all have jobs to do here. Uneven implementation and application of these important standards creates an unlevel playing field where market participants can avoid the new and higher standards by concentrating their activities in those states that have either not adopted or not actually applied such standards – a result we all hope to avoid.

Finally, the OCC and state bank supervisors plan to undertake an important new cooperative initiative involving instances in which national banks use independent mortgage brokers regulated by the states. Superintendent Neiman from New York has been a key player in supporting this new approach, which basically involves coordinating federal and state examination efforts of banks and mortgage brokers with respect to the compliance with the nontraditional mortgage guidance and the subprime mortgage guidance. Starting with two states, New York and Massachusetts, through parallel examinations of a sample of national banks by the OCC, and examinations of a sample of state-licensed mortgage brokers by each state, we hope to develop a baseline of useful compliance information resulting from this unique congruence of state and federal jurisdictional interests.

There is so much that federal and state supervisors can do working together. So in closing, I want to emphasize that I am hopeful – in fact quite optimistic – that the *Watters* decision will be the springboard for collaboration, not confrontation, between federal and state interests, for the benefit of the banking system and its financial services consumers.

Thank you very much. It has been a pleasure to be with you today.