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National Bank Operating Subsidiaries Are Subject to Exclusive Visitorial Authority by OCC as the NBA and OCC Regulations Preempt State Visitorial Authority Law: *Watters v. Wachovia Bank*

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National Bank Operating Subsidiaries Are Subject to Exclusive Visitorial Authority by OCC as the NBA and OCC Regulations Preempt State Visitorial Authority Law: Watters v. Wachovia Bank

UNITED STATES — BANKS AND BANKING — PREEMPTION — The Supreme Court held that an Office of the Comptroller of Currency regulation that interpreted the National Bank Act to treat a national bank operating subsidiary by the same terms and conditions as the parent national bank worked in pari materia with the National Bank Act in preempting state law governing visitorial authority over non-national bank mortgage lending companies.


The facts of this case were simple and undisputed.1 Wachovia Mortgage registered in various states, including Michigan, for the purpose of granting first mortgage loans.2 On January 1, 2003, Wachovia Bank made Wachovia Mortgage into a wholly owned operating subsidiary.3 As a result, Wachovia Mortgage informed the State of Michigan that it would relinquish its mortgage lending registration because it now had a national bank parent in Wachovia Bank.4 The commissioner of Michigan's Office of Insurance and Financial Services (OIFS), petitioner Linda Watters, replied with a letter revoking Wachovia Mortgage's authorization to conduct mortgage lending in Michigan.5

Wachovia Mortgage and Wachovia Bank then filed suit in the United States District Court for the Western District of Michigan,

2. Watters, 127 S. Ct. at 1565.
3. Id. Subsidiary corporation is defined as "[a] corporation in which a parent corporation has a controlling share. — Often shortened to subsidiary." BLACK'S LAW DICTIONARY 368 (8th ed. 2004).
5. Id. Wachovia Mortgage was authorized to conduct mortgage lending in Michigan because of its registration with OIFS. Id. While national banks do not need to be registered with the various states in which they conduct mortgage lending, states require that non-national banks register before authorization will be given to conduct mortgage lending. Id. at 1565-66. In this specific instance, Michigan laws required national bank subsidiary corporations to register before they would become authorized to conduct mortgage lending in Michigan. Id.

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seeking declaratory and injunctive relief against Watters in her official capacity as commissioner. Wachovia Mortgage argued that Watters' authority over it under Michigan law was preempted by the National Bank Act (NBA) and the regulations promulgated by the Office of the Comptroller of Currency (OCC). This authority included requiring mortgage lenders to register with the state, submit financial reports, submit to inspection, and give authorization to the commissioner to regulate or enforce specific acts. Watters disagreed, stating that Wachovia Mortgage was not a national bank and therefore Michigan law was not preempted. Wachovia filed a motion for summary judgment.

The district court held that the NBA prevented state visitorial authority from being exercised over national banks and that regulations promulgated by OCC extended this provision to national banks' operating subsidiaries. Summary judgment was granted to Wachovia Bank, and Watters appealed. The United States Court of Appeals for the Sixth Circuit affirmed the district court decision. The United States Supreme Court granted certiorari to resolve the issue of whether state licensing and auditing agencies govern a national bank's operating subsidiary's mortgage lending activities.

6. Id. at 1565.
7. Id.
8. Id. at 1565-66. The majority stated:
The challenged provisions (1) require mortgage lenders—including national bank operating subsidiaries but not national banks themselves—to register and pay fees to the State before they may conduct banking activities in Michigan, and authorize the commissioner to deny or revoke registrations, (2) require submission of annual financial statements to the commissioner and retention of certain documents in particular format, (3) grant the commissioner inspection and enforcement authority over registrants, and (4) authorize the commissioner to take regulatory or enforcement actions against covered lenders.

Id. (citations omitted).
10. Id.
11. Guthrie v. Harkness, 199 U.S. 148, 158 (1905). This case defined "visitorial authority" as "the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations." Guthrie, 199 U.S. at 158.
15. Id.
16. Id. at 1564.
The Supreme Court affirmed, by a five-to-three vote, the lower court decisions and held that OCC's superintendence over a national bank's mortgage business extended to their operating subsidiaries and preempted any competing state licensing, reporting, and visitorial authority where the operating subsidiary conducts business.  

Justice Ginsburg, writing for the majority, began by citing the NBA, the relevant statutory authority at issue. She recognized that § 484 gave OCC the exclusive authorization of visitorial powers over national banks. The majority continued by citing various cases in which the Court pronounced that the NBA prevented duplicative and burdensome state regulation over national banks. While state regulation existed, the Court identified that the state law would be preempted if it impaired the national bank's authority under the NBA.

Also, Justice Ginsburg reasoned that the NBA granted a national bank authorization to conduct mortgage lending, albeit subject to OCC regulation. Linking the statutes, she stated that OCC has exclusive authority to examine and inspect national banks when those banks engage in mortgage lending. The Court posited that Michigan's laws were in congruence with the federal statute. The necessity of this exclusive authority of OCC over national banks, according to the majority, guarded against resultant confusion emanating from two separate authorities controlling a national bank in the same capacity. Justice Ginsburg con-

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17. *Id.*  
18. *Id.* This statute provided, “No national bank shall be subject to any visitorial powers except as authorized by Federal law . . . .” *Id.* (quoting 12 U.S.C. § 484(a) (2000)).  
20. *Id.* at 1567. “Federally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA.” *Id.* (citing *Davis v. Elmira Sav. Bank,* 161 U.S. 275, 290 (1896)). “[T]he States can exercise no control over [national banks], nor in any wise affect their operation, except in so far as Congress may see proper to permit. Any thing beyond this is an abuse, because it is the usurpation of power which a single State cannot give.” *Id.* (quoting *Farmers' and Mechanics' Nat. Bank v. Dearing,* 91 U.S. 29, 34 (1875)).  
21. *Id.*  
22. *Id.* “Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interest in real estate, subject to 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.” 12 U.S.C. § 371(a) (2000).  
23. *Watters,* 127 S. Ct. at 1568. National banks are “immune from state visitorial control” because exclusive authority to examine and inspect falls with OCC. *Id.*  
24. *Id.*  
25. *Id.* The Court noted that this was precisely what the NBA was designed to prevent: “Th[e] legislation has in view the erection of a system extending throughout the country, and independent, so
cluded that Watters lacked examination authority and enforcement power as Michigan’s OIFS commissioner over a national bank.26

Watters argued that state authority should still control a national bank’s operating subsidiary, although subject to OCC’s superintendence.27 Justice Ginsburg disagreed.28 First, a national bank may conduct banking through an operating subsidiary.29 Furthermore, here, the operating subsidiary was licensed and overseen by OCC in the same way that the national bank would be in conducting the same business.30 The majority explained this resulted from the Gramm-Leach-Bliley Act (GLBA), which authorized an operating subsidiary to conduct certain activities only if a national bank was authorized to do the same.31 In authorizing operating subsidiaries to conduct activities that their national bank parent was authorized to do, GLBA subjected subsidiaries to the same provisions and guidelines that a national bank must follow.32 Justice Ginsburg pointed out that the OCC handbook viewed a national bank and its operating subsidiary as one and

far as 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.”

Id. (quoting Easton v. Iowa, 188 U.S. 220, 229 (1903)).

26. Id. at 1569.
27. Id. Petitioner’s brief stated:

The starting point in discerning Congressional intent is the existing statutory text. The statutory anchor upon which this controversy rests is 12 U.S.C. § 484(a), which provides that “no national bank shall be subject to any visitorial powers except as authorized by federal law” or as vested in the “courts of justice” and congressional authorities. Visitorial powers include the examination and inspection of a national bank’s books and records, as well as the enforcement of laws applicable to a national bank’s operations. The OCC, by adopting 12 C.F.R. 7.4006, has purported to extend the exclusive visitorial powers it has over national banks to the State-chartered nonbank operating subsidiaries of national banks. The plain language of § 484(a) does not permit such an extension; the term “national bank” has a defined meaning that does not encompass nonbank operating subsidiaries such as Wachovia Mortgage.

Brief of Petitioner-Appellant at 12, Watters, 127 S. Ct. 1559 (No. 05-1342) (citations omitted).

28. Watters, 127 S. Ct. at 1569.
29. Id. “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 . . . .” 12 C.F.R. § 5.34(e)(1) (2007).
30. Watters, 127 S. Ct. at 1569. “An operating subsidiary conducts activities authorized under this section 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) (2007).
31. Watters, 127 S. Ct. at 1570. The court mainly relied on this language from GLBA: “subject to the same terms and conditions that govern the conduct of such activities by national banks.” Id. (citing 12 U.S.C. § 24a(g)(3)(A) (2000)).
32. Id.
applied the same standards and controls regardless of which entity was performing the activities.  

The majority recognized that Watters did not dispute OCC's visitorial authority over national bank operating subsidiaries, yet she sought to impose state regulation on them. Watters argued that OCC's authority was not exclusive but rather would exist in lieu of state visitorial authority. The Court rejected this argument and analogized the burdens of duplicative state and federal regulation over national banks as equally burdensome on operating subsidiaries.

The Court continued, noting that the interpretation of the NBA's preemptive force previously had been extended beyond a national bank. The Court did not look to the corporate structure of the operating subsidiary to make its determination; rather the Court equated operating subsidiaries to national banks because of the powers granted to the national bank by the NBA. Also, the majority noted that the guards against state interference of national banks when conducting business should extend to OCC-licensed operating subsidiaries conducting the same.

Watters complained that if Congress intended to deny visitorial powers to states over OCC licensed operating subsidiaries in addition to national banks, Congress would have expressed this explicitly in the NBA. The majority dismissed her argument for two reasons. First, the Court argued that no Congressional intent could be discerned from the NBA concerning operating subsidiaries because operating subsidiaries did not emerge until 1966, long after the statute's enactment in 1884. Further, Justice Ginsburg

33. Id.
34. Id.
35. Id.
36. Watters, 127 S. Ct. at 1570.
37. Id.
38. Id. at 1571. The Court explained:

[W]e upheld OCC's determination that national banks had "incidental" authority to act as agents in the sale of annuities. It was not material that the function qualifying as within "the business of banking," § 24 Seventh, was to be carried out not by the bank itself, but by an operating subsidiary. Id. (quoting Nations Bank of N.C., N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256 (1995)).
39. Id.
40. Id.
41. Watters, 127 S. Ct. at 1571. The argument rested on Wachovia Mortgage's being considered an "affiliate." Id. The court later distinguished operating subsidiaries as being a type of affiliate. Id.
42. Id. at 1571. "Over the past four decades, during which operating subsidiaries have emerged as important instrumentalities of national banks, Congress and OCC have indi-
rejected the argument because Congress and OCC had since dictated that operating subsidiaries were subject to state law in the same way as their national bank parents.\(^4\)

Second, Justice Ginsburg rejected Watters’ argument because the petitioner failed to make a distinction between an affiliate and an operating subsidiary.\(^4\) Watters’ argument that national bank affiliates were still subject to state visitorial authority was rejected by the Court because affiliates were able to conduct activities that national banks were not allowed to do.\(^4\) According to the majority, an operating subsidiary was just one type of affiliate.\(^4\)

In fact, Justice Ginsburg identified the difference by indicating that GLBA explicitly authorized operating subsidiaries to only conduct business that a national bank would be authorized to do independently.\(^4\) This difference allowed the Court to subject operating subsidiaries to a different analysis than affiliates generally.\(^4\)

Finally, Justice Ginsburg noted that the OCC regulation at issue clearly applied state law to operating subsidiaries and national banks in the same manner.\(^4\) The Court rejected Watters’ argument that OCC lacked authority to preempt state law by promulgating this regulation.\(^4\) The majority stated that the OCC regulations merely illuminate what the NBA expresses.\(^4\) State law cannot interfere with OCC’s exclusive visitorial authority over

\(^4\) Duquesne Law Review

\(^4\) Id.

\(^4\) Id. Affiliate as defined by the NBA is “any corporation controlled by a national bank, including a subsidiary.” Id. (citing 12 U.S.C. § 221a(b) (2000)).

\(^4\) Id.

\(^4\) Id. at 1571.

\(^4\) Id. at 1572. Justice Ginsburg stated:

Notably, when Congress amended the NBA confirming that operating subsidiaries may “engag[e] solely in activities that national banks are permitted to engage in directly,” 12 U.S.C. § 24a(g)(3)(A), it did so in an Act, the GLBA, providing that other affiliates, authorized to engage in nonbanking financial activities, e.g., securities and insurance, are subject to state regulation in connection with those activities.

\(^4\) Id.

\(^4\) Id. “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 (2007).

\(^5\) Id. at 1572. The Court stated: “[i]n our interpretation of the statute, the level of deference owed to the regulation is an academic question.” Id.

\(^5\) Id. “Section 7.4006 merely clarifies and confirms what the NBA already conveys.” Id.
national banks; as a result, as operating subsidiaries are dealt with in the same manner, this preemption of state law was extended.\(^5\)

Justice Stevens wrote the dissent for a three-justice minority.\(^5\) He focused foremost on the majority's lack of a direct provision promulgated by Congress to immunize a national bank's operating subsidiary from state laws.\(^5\) This should have, in Justice Stevens' analysis, prohibited the Court from ruling in favor of preemption.\(^5\)

In analyzing a preemption case, Justice Stevens wrote that it was paramount to construe the purpose of Congress.\(^5\) According to the dissent, interpreting the congressional purpose must begin with the assumption that federal acts will not preempt the police powers of the state absent a clear statement by Congress.\(^5\) Justice Stevens then wrote that the NBA failed to state their purpose in this regard.\(^5\) The dissenting Justices argued that Congress has never extended the NBA's preemptive force to operating subsidiaries.\(^5\) The dissenting opinion stated that the correct interpretation of Congress' silence in regards to national bank "affiliates" in its explicit preemption language in the NBA was that the provision should only be applied to national banks.\(^5\)

The majority expressed that Congress would not normally want a state to interfere with powers expressly granted to a national

\(^5\) Id. "A national bank has the power to engage in real estate lending through an operating subsidiary, subject to the same terms and conditions that govern the national bank itself; that power cannot be significantly impaired or impeded by state law." Id.

\(^5\) Id. at 1573 (Stevens, J., dissenting).

\(^5\) Id.

\(^5\) Watters, 127 S. Ct. at 1573 (Stevens, J., dissenting). Joining Justice Stevens in the dissent were Chief Justice Roberts and Justice Scalia. Id. Justice Thomas took no part in the case. Id.

\(^5\) Id. at 1578. "[T]he purpose of Congress is the ultimate touchstone of pre-emption analysis." Id. (quoting Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992)).

\(^5\) Id. "[I]n all pre-emption cases . . . we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." Id. (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).

\(^5\) Id.

\(^5\) Id. "Although this exemption from state visitorial authority has been in place for more than 140 years, . . . it is significant that Congress has never extended 12 U.S.C. § 484(a)'s preemptive blanket to cover national bank subsidiaries." Id.

\(^5\) Id. Watters, 127 S. Ct. at 1579 (Stevens, J., dissenting). "That Congress lavished such attention on national bank affiliates and conferred such far-reaching authority on the OCC without ever expanding the scope of § 484(a) speaks volumes about Congress' preemptive intent, or rather its lack thereof." Id.
bank by Congress, and Justice Stevens questioned this reliance.\textsuperscript{61} Any reliance on what Congress would normally want, said the dissent, was meaningless when Congress had expressed its preferences.\textsuperscript{62} Because Congress has only expressly preempted laws that give states visitorial authority over national banks, Justice Stevens posited that extending this preemption to operating subsidiaries was erroneous.\textsuperscript{63}

The dissent also attacked the majority's reliance on language in GLBA stating that operating subsidiaries should be treated in the same manner as their parent national bank.\textsuperscript{64} Justice Stevens questioned such language, pointing out that it does not exist in a provision regarding preemption, but exists in the definition of the term financial subsidiary.\textsuperscript{65} Further, the GLBA's failure to mention operating subsidiaries troubled the dissent.\textsuperscript{66} The three Justices concluded that this language cannot be interpreted as preemting state law regarding operating subsidiaries.\textsuperscript{67} Justice Stevens thought this reality was even more apparent when viewed against the fact that GLBA dedicates other provisions that explicitly called for preemption.\textsuperscript{68}

The dissenters also questioned whether Congress authorized OCC to preempt state law when regulating operating subsidiaries.\textsuperscript{69} Justice Stevens argued that Congress did not authorize OCC to preempt state laws—something with which Congress has a wealth of experience.\textsuperscript{70} The dissent explained that there was a stark distinction between granting authority to immunize an operating subsidiary from state law and granting authority to regulate an operating subsidiary.\textsuperscript{71} While the NBA grants OCC the

\textsuperscript{61} Id. "As we explained in \textit{Barnett Bank}, this Court take[s] the view that \textit{normally} Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress has explicitly granted." \textit{Id.} (citing \textit{Barnett Bank of Marion County, N.A. v. Nelson}, 517 U.S. 25 (1996)).

\textsuperscript{62} Id.

\textsuperscript{63} Id. at 1581.

\textsuperscript{64} Id. The language referred to is the phrase "same terms and conditions." \textit{Id.}

\textsuperscript{65} \textit{Watters}, 127 S. Ct. at 1581 (Stevens, J., dissenting).

\textsuperscript{66} Id.

\textsuperscript{67} Id.

\textsuperscript{68} Id. "Congress in fact disavowed any such preemptive intent. Section 104 of the GLBA is titled 'Operation of State Law,' 113 Stat. 1352, and it devotes more than 3,000 words to explaining which state laws Congress meant the GLBA to preempt." \textit{Id.}

\textsuperscript{69} Id. at 1582.

\textsuperscript{70} \textit{Watters}, 127 S. Ct. at 1582 (Stevens, J., dissenting).

\textsuperscript{71} Id. at 1583.
latter power, Justice Stevens contended it did not grant OCC the former.\textsuperscript{72}

Justice Stevens argued that the OCC regulations were not intended to preempt state law, but to convey the OCC's prediction of what a federal court would decide.\textsuperscript{73} The dissent disagreed with OCC.\textsuperscript{74} Justice Stevens added that the interpretation here should not involve the regulation but rather the statute.\textsuperscript{75} He reemphasized that the GLBA language lacked any statement of preemption.\textsuperscript{76}

Finally, Justice Stevens attacked the majority's underlying policy argument that preemption gives national banks the ability to use operating subsidiaries as the equivalent of departments of the banks themselves.\textsuperscript{77} The dissent reasoned that a national bank need only create a division or department, if that was its goal; a national bank need not acquire or form a separate operating subsidiary.\textsuperscript{78} Justice Stevens stressed the importance of the choice of corporate structure because giving immunity from state visitorial authority to operating subsidiaries results in a negative impact to the competitive equality that the dual banking system created.\textsuperscript{79}

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\textsuperscript{72} Id.
\textsuperscript{73} Id. at 1584. "Taking the OCC at its word, then, § 7.4006 has no preemptive force on its own, but merely predicts how a federal court's analysis will proceed." Id.
\textsuperscript{74} Id. The dissent, in determining this, went through the steps the OCC took in forming § 7.4006. Id. The court stated:

First, the OCC observed that the GLBA "expressly acknowledged the authority of national banks to own subsidiaries" that conduct national bank activities "subject to the same terms and conditions that govern the conduct of such activities of national banks." The agency also noted that it had folded the "same terms and conditions" language into an implementing regulation. According to the OCC, "[a] fundamental component of these descriptions of the characteristics of operating subsidiaries in GLBA and OCC's rule is that state laws apply to operating subsidiaries to the same extent as they apply to the parent national bank."

Id. (citations omitted).
\textsuperscript{75} Watters, 127 S. Ct. at 1584 (Stevens, J., dissenting).
\textsuperscript{76} Id.
\textsuperscript{77} Id. at 1585. "[N]ational banks might desire to conduct their business through operating subsidiaries for the purposes of controlling operations costs, improving effectiveness of supervision, more accurate determination of profits, decentralizing management decisions [and] separating particular operations of the bank from other operations." Id. (citation and internal quotation marks omitted).
\textsuperscript{78} Id.
\textsuperscript{79} Id. Justice Stevens' policy reasons underlying his dissent surrounded the argument that, "the OCC's regulation is about far more than mere corporate structure or internal governance," but rather, "[i]t is about whether a state corporation can avoid complying with state regulations, yet nevertheless take advantage of state laws insulating its owners from liability." Id. (citations omitted).
In the landmark case of \textit{McCulloch v. Maryland}, Chief Justice Marshall established the first case law on federal preemption of state law in the realm of national banking.\textsuperscript{80} Nearly fifty years later, near the end of the Civil War, the NBA was enacted, allowing banks to incorporate as national banks.\textsuperscript{81} Aside from the various enumerated powers that were vested in national banks, they were also given any other powers essential to conducting their business.\textsuperscript{82} When enacted, the NBA also explicitly preempted state law by granting the newly created OCC exclusive visitorial authority over national banks.\textsuperscript{83} At the time, many believed that state banks would become obsolete, but the opposite occurred; a dual banking system was created.\textsuperscript{84}

When the NBA was enacted, operating subsidiaries were not yet recognized (or even conceptualized), though banks began to affiliate with other corporate entities and investing in businesses.\textsuperscript{85} During the Great Depression, these affiliates were thought to play a large role in many bank closings, inevitably leading to the enactment of the Glass-Steagall Act in 1933.\textsuperscript{86} The Glass-Steagall Act forbade affiliation with investment banks by any member of the Federal Reserve.\textsuperscript{87} Soon thereafter, national banks were prohibited from owning stock in any company, a move by Congress to further limit bank affiliation with other corporate entities.\textsuperscript{88}

It was the Comptroller of the Currency in 1966 that officially acknowledged operating subsidiaries and declared that national banks could own operating subsidiaries so long as the entity was performing an activity that national banks were authorized to conduct.\textsuperscript{89} After an attempt in 1996 by the OCC to permit operat-

\begin{itemize}
  \item \textsuperscript{80} 17 U.S. 316, 336 (1819).
  \item \textsuperscript{81} \textit{Watters}, 127 S. Ct. at 1566 (majority opinion).
  \item \textsuperscript{82} 12 U.S.C. § 24 (2000). This statute provides "all such incidental powers as shall be necessary to carry on the business of banking." \textit{Id.}
  \item \textsuperscript{83} \textit{Id.} § 484(a). This statute provides: "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law." \textit{Id.}
  \item \textsuperscript{84} \textit{Watters}, 127 S. Ct. at 1574 (Stevens, J., dissenting). The dual banking system is the term used to describe the banking system in the United States which consists of both nationally chartered "national banks" as well as state-chartered banks and other lending institutions. Edward L. Symons, \textit{The United States Banking System}. 19 Brook. J. Int'l L. 1, 9 (1993).
  \item \textsuperscript{85} \textit{Watters}, 127 S. Ct. at 1576.
  \item \textsuperscript{87} \textit{Watters}, 127 S. Ct. at 1576 (Stevens, J., dissenting).
  \item \textsuperscript{88} \textit{Id.} at 1576-77.
  \item \textsuperscript{89} \textit{Id.} at 1577. "[A] national bank may acquire and hold the controlling stock interest in a subsidiary operations corporation" so long as that corporation's 'functions or activities'.
ing subsidiaries to conduct business from which national banks were prohibited, Congress passed GLBA, which impliedly distinguished operating subsidiaries and financial subsidiaries. 90

While mortgage lending under the original NBA was prohibited, over the last century, such prohibitions have been lifted. 91 In 1982, the current language of the statute was enacted to authorize national banks to conduct mortgage lending and to give national banks broad powers in that regard. 92 Because national banks, therefore, were authorized to conduct mortgage lending, their operating subsidiaries were authorized to do the same. 93

Ultimately, a 2001 regulation promulgated by the Comptroller of Currency led to the development of the present issue when it was declared that a national bank's operating subsidiary was subject to state law in the same manner as the national bank parent. 94 Soon thereafter, numerous wholly owned operating subsidiaries, and their national bank parents, challenged various state regulations, which would lead to litigation across the nation. 95 Four courts of appeals addressed the issue before the Supreme Court granted certiorari in the present case. 96

The Court of Appeals for the Second Circuit in Wachovia Bank, N.A. v. Burke, 97 as well as the other courts of appeals to address the issue, held as the Supreme Court eventually would in Watters, that state regulations over national bank operating subsidiaries

90. Id. Operating subsidiaries were companies that performed only activities that national banks could perform themselves, while financial subsidiaries were companies that could perform other activities, albeit with harsher regulations. Id.

91. Id. at 1576.

92. National Bank Act, 12 U.S.C. § 371 (2000). This statute provided: “[a]ny national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.” Id. § 371(a).

93. Watters, 127 S. Ct. at 1576 (Stevens, J., dissenting).


95. Watters, 127 S. Ct. at 1565 n.1.

96. Id. (citing Nat’l City Bank of Ind. v. Turnbaugh, 463 F.3d 325 (4th Cir. 2006); Wachovia Bank v. Watters, 431 F.3d 556 (6th Cir. 2005), aff’d 127 S. Ct. 1559 (2007); Wells Fargo Bank, N.A. v. Boutris, 419 F.3d 949 (9th Cir. 2005); Wachovia Bank, N.A. v. Burke, 414 F.3d 305 (2d Cir. 2005)).

97. 414 F.3d 305.
were preempted by the NBA and OCC regulations.\textsuperscript{98} However, vast differences existed in their analysis.\textsuperscript{99}

The Second Circuit's decision in \textit{Burke} involved the same national bank and its operating subsidiary as in the present case, albeit in the state of Connecticut.\textsuperscript{100} The facts of \textit{Burke} were simple and undisputed.\textsuperscript{101} As previously mentioned, Wachovia Mortgage became a wholly owned operating subsidiary of Wachovia Bank on January 1, 2003.\textsuperscript{102} As they had done so in Michigan, Wachovia Mortgage relinquished its mortgage licenses with John P. Burke in his official capacity as Banking Commissioner of the state of Connecticut.\textsuperscript{103} Less than two months later, Burke responded with a Notice of Intent to Issue a Cease and Desist Order directed at Wachovia Mortgage, believing it to be conducting mortgage lending business without a license.\textsuperscript{104} Wachovia then filed suit against Burke in the United States District Court for the District of Connecticut.\textsuperscript{105}

The court of appeals, like the majority in the present case, detailed the relevant statutory authority of the NBA and the relevant OCC regulations.\textsuperscript{106} However, unlike Justice Ginsburg, the court of appeals embarked on a preemption analysis that largely incorporated the landmark case of \textit{Chevron U.S.A., Inc. v. Natural Resources Defense Council}.\textsuperscript{107} \textit{Chevron} outlined a two-step test to determine whether a federal regulation that purported to preempt state law did in fact lead to preemption.\textsuperscript{108} The first step is finding out whether Congress has expressly dictated an intent to preempt state law.\textsuperscript{109} If it has, the analysis is over, because Congress' intent has been manifested and the regulation either abides by it or runs counter to it.\textsuperscript{110} Where Congress has not expressly dictated its intent, or where that intent is ambiguous, the second step

\begin{itemize}
\item \textsuperscript{98} \textit{Watters}, 127 S. Ct. at 1565.
\item \textsuperscript{99} \textit{Burke}, 414 F.3d at 324.
\item \textsuperscript{100} \textit{Id.} at 309.
\item \textsuperscript{101} \textit{Id.} at 310.
\item \textsuperscript{102} \textit{Id.}
\item \textsuperscript{103} \textit{Id.}
\item \textsuperscript{104} \textit{Burke}, 414 F.3d at 310.
\item \textsuperscript{105} \textit{Id.}
\item \textsuperscript{106} \textit{Id.} at 311-13.
\item \textsuperscript{107} \textit{Id.} at 315 (citing \textit{Chevron U.S.A., Inc. v. Natural Res. Def. Council}, 467 U.S. 837, 842 (1984)).
\item \textsuperscript{108} \textit{Chevron}, 467 U.S. at 842.
\item \textsuperscript{109} \textit{Id.}
\item \textsuperscript{110} \textit{Id.} "First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter." \textit{Id.}
must be taken. That step focuses on the reasonableness of the federal agency’s interpretation of the statute in promulgating the federal regulation. If the agency gave a reasonable construction to the statute, the courts should defer to the agency’s interpretation and find preemption.

The judges of the Second Circuit first turned, as dictated by the *Chevron* rule, to whether Congress had expressly dictated its intent to preempt through the NBA. Finding language that clearly stated that OCC has exclusive visitorial authority over national banks, the judges noted that no mention was made of operating subsidiaries. Burke argued that Congress expressly gave exclusive visitorial authority over national banks to OCC, but did not do so in regards to their “affiliates.” Congressional silence, according to Burke, showed Congress did not intend to give visitorial authority to OCC in regards to operating subsidiaries.

After concluding that no express congressional intent was dictated, the court of appeals determined whether the particular OCC regulation enacted under a reasonable construction of the NBA. Commissioner Burke mainly attacked the OCC regulation’s underlying rationale: an operating subsidiary was essentially equivalent to a national bank division or department and therefore was apt to be treated in the same manner as the national bank itself.

Wachovia countered by arguing that there are benefits for national banks to owning operating subsidiaries as opposed to simply having them organized as a division of the national bank. The court of appeals favored the argument of Wachovia and OCC

111. *Id.* at 843.
112. *Id.*
113. *Chevron*, 467 U.S. at 843. “[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.” *Id.*
114. *Burke*, 414 F.3d at 315.
115. *Id.* “No national bank shall be subject to any visitorial powers except as authorized by Federal law.” *Id.* (quoting 12 U.S.C. § 484 (2000)).
116. *Id.* at 315-16.
117. *Id.* at 316-18. The court of appeals rejected this argument because operating subsidiaries were just one type of national bank “affiliate,” and “affiliates” encompassed a much broader category that was more heavily regulated. *Id.*
118. *Id.* at 318.
119. *Burke*, 414 F.3d at 318. “The Commissioner focuses on and attacks a particular rationale expressed for 12 C.F.R. § 7.4006: that ‘operating subsidiaries are, in essence, incorporated departments or divisions of the bank, and, accordingly, should not be treated differently than their parent banks.’” *Id.* (quoting 66 Fed. Reg. 34,788 (July 2, 2001)).
120. *Id.*
that state regulations should not hinder a national bank's choice for a more desirable corporate organization model.  

Ultimately, the court of appeals found that the OCC regulation was promulgated under a reasonable construction of the NBA, evidenced by policies guarding against state interference of national bank operations and national banks' use of operating subsidiaries. In finding the regulation reasonable, the court of appeals determined that OCC should be given Chevron deference and held that state law was preempted. A few short months later, Wachovia Bank's nearly identical case in Michigan was decided by the court of appeals, this time in the Sixth Circuit. Following the same analysis as the Second Circuit, the Sixth Circuit held that OCC should be given Chevron deference and therefore the state laws requiring state visitorial authority were preempted. Justice Ginsburg never even mentioned Chevron in the holding, yet affirmed the Sixth Circuit's decision.

The majority opinion is sound in its analysis despite the vigorous and compelling dissent by Justice Stevens. Justice Stevens' more interesting argument focuses on the corporate structure of Wachovia Mortgage rather than the OCC regulation itself. Stevens contended that Wachovia Mortgage was a state-incorporated bank that benefits from the limited liability that incorporation brings and therefore should be subject to state regulation in the form of visitorial authority. The fact that Wachovia Mortgage operated under state regulations for six years before becoming an operating subsidiary of Wachovia Bank bolstered Stevens' argument. The argument rests mainly upon a policy favoring the competitive equality that the dual-banking system has thrived upon.

It is a compelling argument when viewed from the position of state mortgage lending banks that do not have national bank parents. From that point of view, competitors with national bank

121. Id.
122. Id. at 321.
123. Id. at 324.
125. Wachovia, 431 F.3d at 563.
126. Watters, 127 S. Ct. at 1573.
127. Id. at 1585 (Stevens, J., dissenting).
128. Id.
129. Brief for the Nat'l Ass'n of Realtors as Amicus Curiae in Support of Petitioner at 14-15, Watters, 127 S. Ct. 1559 (No. 05-1342) [hereinafter Amicus Brief].
130. Id. at 13.
131. See id. at 14.
parents gain a competitive advantage by avoiding state visitorial authority.\textsuperscript{132} National bank parents benefit as well, being shielded from any liability because of the corporate structure of a separate operating subsidiary.\textsuperscript{133} As a result, Watters and others argued that operating subsidiaries should be seen as national bank affiliates, subject to dual regulations in this regard.\textsuperscript{134} Such a contention addressed the idea that it is unfair for operating subsidiaries to get the best of both worlds in terms of the limited liability garnered by creating a separate corporate entity as well as the preemptive force granted to national banks under the NBA in terms of visitorial authority.\textsuperscript{135}

Ultimately, however, such arguments failed on sound reasoning by Justice Ginsburg and the majority.\textsuperscript{136} In terms of competitive equality, it does not seem that operating subsidiaries will obtain a competitive advantage. For instance, while Wachovia Mortgage for six years operated under the superintendence of Watters in Michigan, it was not subject to OCC superintendence.\textsuperscript{137} If the minority view had prevailed, Wachovia Mortgage would have been subject to both while its state registered competitors were only subject to state regulation, arguably a competitive disadvantage.

Furthermore, the majority relied on the reality that operating subsidiaries were treated the same way as their national bank parents.\textsuperscript{138} This contrasts national bank affiliates that garner increased regulation because of their ability to carry on functions that national banks were not allowed to perform themselves.\textsuperscript{139} Operating subsidiaries on the other hand may only conduct business that their national bank parent would be able to conduct on their own.\textsuperscript{140} This difference has proved to be meaningful. As pointed out in the majority opinion, in regulating the accounting reports, OCC calculates the assets and liabilities of the national bank together with its operating subsidiaries' assets and liabilities and does the same in regards to regulatory limits.\textsuperscript{141} Financial subsidiaries are not afforded the same privileges.\textsuperscript{142}

\textsuperscript{132} Id.
\textsuperscript{133} Watters, 127 S. Ct. at 1585 (Stevens, J., dissenting).
\textsuperscript{134} Id. at 1571 (majority opinion).
\textsuperscript{135} Amicus Brief, supra note 129, at 12.
\textsuperscript{136} Id. at 1571.
\textsuperscript{137} Amicus Brief, supra note 129, at 12.
\textsuperscript{138} Watters, 127 S. Ct. at 1572.
\textsuperscript{139} Id. at 1571.
\textsuperscript{140} Id.
\textsuperscript{141} Id. at 1570 n.10. The opinion states:
In terms of the overall consequences of the case, it is unlikely much will change economically. There are some concerns that consumers will be hurt because OCC regulations tend to be less stringent than state regulations, but this argument lacks merit. The vast majority of state regulations of mortgage lenders will be largely unaffected by this opinion, and merely the governmental body that exercises formal control in terms of superintendence will change. The fundamental tools in evaluating these entities will not change, and if it is found that reform is needed in this area in terms of OCC's potentially "inefficient" superintendence, national reform seems a better avenue than state based initiatives.

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For example, "for purposes of applying statutory or regulatory limits, such as lending limits or dividend restrictions, the results of operations of operating subsidiaries are consolidated with those of its parent. Likewise, for accounting . . . purposes, an operating subsidiary is treated as part of the member bank; assets and liabilities of the two entities are combined. OCC treats financial subsidiaries differently. A national bank may not consolidate the assets and liabilities of a financial subsidiary with those of the bank."

Id. (citations omitted).

142. Id.