

Viewpoint: Where Watters Decision May Lead Us

From: American Banker

Friday, June 22, 2007

By Kevin J. Handly and Stefan L. Jouret

In April the Supreme Court held in *Watters v. Wachovia* that the National Bank Act and certain OCC regulations "preempt" states' consumer protection laws that subject a national bank's operating subsidiary to state licensing, reporting, and supervision.

Lower courts wasted little time in interpreting *Watters* as a green light to force states out of the consumer protection game, at least where federally chartered banks or thrifts are concerned. In *Watters'* wake, House Financial Services Committee Chairman Barney Frank and others have openly questioned whether the OCC and the OTS are really equipped to take over the consumer protection side of business regulation, given their traditional emphasis on bank safety and soundness and promoting the federal banking charter.

Recently, citing *Watters*, the U.S. Court of Appeals for the First Circuit held in *SPGGC v. Ayotte* that New Hampshire's statute prohibiting "dormancy" and other administrative fees on gift certificates cannot be applied to retailers' stored-value cards if the cards are issued by a federally chartered bank or thrift.

The message to state regulators is that when a federally chartered bank is involved, it's strictly "hands off." Left in doubt, for now, is whether a state can regulate anything having to do with the "business of banking" as practiced by federally chartered institutions.

When one adds to this mix the steadfast refusal of the OCC and the federal courts to recognize any durable boundaries on what constitutes the "business of banking" as conducted by national banks, the endpoint of this line of preemption decisions becomes clear — the federalization of business regulation generally and the neutralization of state consumer protection laws.

The competitive advantages national banks derive from their preemptive federal charters have not been lost on other business sectors. Why else do you think the nation's largest insurance companies — formerly the guardians of the McCarran Ferguson Act and exclusive state regulation of the insurance business — are suddenly clamoring for a federal insurance charter as an alternative to state incorporation statutes? When, as the federal courts have held, a federal corporate charter carries an automatic blanket exemption from state consumer protection regulations, what consumer business wouldn't want a federal charter?

Federal banks and the insurance industry should be careful what they wish for.

If states continue to be prevented from enforcing their consumer protection laws, one or two bad actors exploiting regulatory gaps can tarnish the entire industry. When that happens, consumers, Congress, and the courts will expect federal chartering authorities to identify, root out, and prevent abusive practices by the businesses they charter. Federal agencies originally set up to nurture a competitive alternative to dominant and unresponsive state-chartered banks may train their considerable enforcement powers and resources on the businesses they charter in aid of the consumer.

If that happens, businesses may only wish they had a viable state regulatory alternative.

Mr. Handly is a shareholder-director at the Boston office of Gallagher, Callahan & Gartrell PC and a former senior litigation and enforcement attorney at the Federal Reserve Board. Mr. Jouret is an associate in the Boston office of Donovan Hatem LLP and a former majority legal counsel to the U.S. House Financial Services Committee.

© 2007 American Banker and SourceMedia, Inc. All rights reserved.