

GAO

Report to the Subcommittee on Oversight
and Investigations, Committee on
Financial Services, House of
Representatives

October 2005

OCC PREEMPTION RULEMAKING

Opportunities Existed to Enhance the Consultative Efforts and Better Document the Rulemaking Process



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-06-8](#), a report to the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

Why GAO Did This Study

On January 13, 2004, the Office of the Comptroller of the Currency (OCC) issued two sets of rules (the preemption rules) on the extent to which the National Bank Act preempts the application of state and local laws to national banks and their operating subsidiaries. The rules and the manner in which OCC promulgated them generated considerable controversy. Some state officials, consumer groups, and congressional members questioned whether OCC adhered to the statutes and executive orders pertaining to rulemaking and whether the process was as inclusive as it could have been. GAO (1) assessed OCC's rulemaking process within the framework of applicable laws and executive orders, (2) described the issues raised in comment letters and OCC's responses, and (3) identified and discussed stakeholder concerns about how OCC promulgated its preemption rules.

What GAO Recommends

GAO is not making recommendations because OCC generally followed laws and executive orders. GAO makes observations on how OCC could enhance consultation and better document its rulemaking process. In its comments, OCC agreed to develop detailed written procedures, disagreed with GAO's observations about the sufficiency of documentation and consultation relative to the executive orders, but intends to enhance its consultation.

www.gao.gov/cgi-bin/getrpt?GAO-06-8.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov.

OCC PREEMPTION RULEMAKING

Opportunities Existed to Enhance the Consultative Efforts and Better Document the Rulemaking Process

What GAO Found

Federal preemption of state law affecting national banks always has been controversial and seems to have become more so with consolidation in the financial services industry, which has resulted in the presence of large national banks in nearly every state. OCC followed the statutory framework for rulemaking and appears to have followed applicable executive orders, but it was difficult to fully determine the basis for some agency actions or assess the extent of its consultation with stakeholders because OCC did not always document its actions. The agency also lacked its own guidance or procedures for its rulemaking process and instead used a rulemaking checklist as a guide for completing reviews and routing documents. Federal internal control standards call for documenting actions to verify that an agency has complied with its policies and applicable law. The standards also call for agencies to follow written procedures in making important decisions, to provide a framework for ensuring compliance with management directives and applicable law and regulations. Without such documentation and procedures, evidence to substantiate OCC's actions was limited.

OCC considered all of the approximately 2,700 comment letters it received on its banking activities proposal, but strongly disagreed with comments questioning its preemptive authority and the rules' adverse effect on consumers. GAO's analysis of the letters revealed that commenters were concerned that the rule could diminish enforcement of state consumer protection laws, questioned the bases for OCC's legal analysis and conclusions, and posited adverse effects on state-chartered banks. In response, OCC contended that it has a comprehensive consumer protection effort for national banks, reiterated its preemptive authority, and asserted the rule would preserve the "dual banking" system. However, OCC agreed with some issues raised in the public comments and made some changes to the final rules. For instance, OCC included an explicit reference to a provision of the Federal Trade Commission Act that prohibits national banks from engaging in practices considered unfair and deceptive.

Most criticism about how OCC promulgated the rules focused on what some believed was a lack of opportunity to discuss and comment on the proposed rules. Although OCC briefed several congressional members about the proposals before they were published, some criticized OCC for issuing the rules while Congress was in recess and not allowing time for hearings on the rules. OCC officials told GAO that a lengthy delay would have harmed banks' ability to securitize their loans, left consumers with fewer choices, or imposed burdensome costs on banks seeking to comply with a multitude of state laws. According to consumer groups, OCC could and should have offered additional mechanisms for soliciting public input—such as public meetings. Some financial institution regulators have used other means besides the comment period to solicit input for rulemakings they deemed controversial. GAO observed that such efforts, while not required, might have contributed to a better understanding about the rules.

Contents

Letter

Results in Brief	1
Background	5
OCC Generally Followed Rulemaking Requirements but Lacked Documentation and Written Guidance, Making It Hard to Verify Consultation Efforts	8
OCC Considered All Comments on Its Banking Activities Rule, and Strongly Disagreed with Those Challenging Its Authority, but Made Some Changes in Response to Others	14
Stakeholders Raised Issues Regarding the Process OCC Used to Promulgate Its Preemption Rules	29
Observations	40
Agency Comments and Our Evaluation	44
	46

Appendixes

Appendix I: Objectives, Scope, and Methodology	48
Appendix II: Comments from the Office of the Comptroller of the Currency	52
Appendix III: GAO Contact and Staff Acknowledgments	55

Figures

Figure 1: OCC Informal Rulemaking Procedures	22
Figure 2: Sample OCC Rulemaking Checklist	24
Figure 3: Composition of Commenters, Based on Our Analysis of 373 Nonform Letters	31
Figure 4: Frequently Cited Concerns of Selected Commenters Opposed to OCC's Banking Activities Proposal	33

Abbreviations

APA	Administrative Procedure Act
CRA	Congressional Review Act
CSBS	Conference of State Bank Supervisors
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
LRA	Legislative and Regulatory Activities Division
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
RFA	Regulatory Flexibility Act
SEC	Securities and Exchange Commission
UMRA	Unfunded Mandates Reform Act

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office
Washington, D.C. 20548

October 17, 2005

The Honorable Sue W. Kelly
Chairwoman
The Honorable Luis V. Gutierrez
Ranking Minority Member
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives

In the National Bank Act, Congress created the Office of the Comptroller of the Currency (OCC) to supervise national banks.¹ In its capacity as the supervisor of national banks, OCC issues regulations, policies, and interpretations to establish standards, define acceptable practices, provide guidance on risks, and prohibit or restrict practices. However, OCC traditionally has issued opinions, rather than rules or regulations, on whether the National Bank Act preempts state laws that impose standards or restrictions on the business of national banks. In contrast, on January 13, 2004, OCC issued two final rules (preemption rules) on the extent to which the National Bank Act preempts the application of state and local laws to national banks and their operating subsidiaries.² The rules and the manner in which OCC promulgated them generated considerable controversy and debate, including questions about OCC's authority to issue the rules.

According to OCC, the two sets of rules "codified" judicial decisions and OCC opinions on preemption under the National Bank Act by making them generally applicable and clarified certain issues. More specifically, as stated by OCC, the visitorial powers rule clarifies that federal law commits the supervision of national banks' banking activities exclusively to OCC (except where federal law provides otherwise) and that states may not use

¹In the 1830s, state banks became the primary source of paper currency, issuing notes against their reserves. Congress enacted the National Currency Act in 1863, which limited the power of state banks to issue notes, established a national bank charter, and created OCC, among other things. OCC is a bureau of the U.S. Department of the Treasury. 12 Stat. 665 (1863). In 1864, Congress revised the National Currency Act (renamed the National Bank Act) to provide for comprehensive OCC regulation of national banks. Although OCC is a bureau of the Treasury, it is an independent office within Treasury. In 1994, Congress amended the National Bank Act to describe OCC's autonomy with respect to rulemaking. Pub. L. No. 103-325 § 331(b).

²69 Fed. Reg. 1895 (visitorial powers); 69 Fed. Reg. 1904 (national bank activities).

judicial actions as an indirect means of regulating those activities.³ The second rule, which we refer to in this report as the banking activities rule, preempts categories of state laws that relate to bank activities and operations, describes the test for preemption that OCC will apply to state laws that do not fall within the identified categories, and lists certain types of state laws that are not preempted.⁴ In proposing the banking activities rule, OCC stated that it needed to provide timely and more comprehensive standards about the applicability of state laws to lending, deposit taking, and other authorized activities of national banks because of the number and significance of questions banks were posing about preemption in those areas.⁵

The proposed rules and OCC's rulemaking process drew strong reactions of either support or opposition from the banking industry, state legislators, attorneys general, and other officials, consumer group representatives, and some Members of Congress. For example, all of the state attorneys general questioned whether OCC reasonably analyzed the case for preemption. In a comment letter on the banking activities proposals, they stated that the National Bank Act was not intended to divest all state authority over national banks, and under Supreme Court precedent, national banks are subject to state laws that do not conflict with the powers of national banks or discriminate against national banks. Further, opponents such as consumer groups and state legislators feared that the preemption of state law, particularly with respect to predatory lending practices, would weaken consumer protections. In contrast, proponents contended that replacing differing state laws with a consistent standard would increase the health of the banking system. However, opponents countered that OCC's actions could have far-reaching effects on the banking industry, such as undermining the "dual banking system," by conferring undue benefits to federally chartered banks at the expense of state-chartered banks.⁶

³12 C.F.R. § 7.4000 (2005).

⁴12 C.F.R. §§ 7.4007, 7.4008, 7.4009, 34.3, 34.4 (2005). These regulations also contain an anti-predatory lending standard and discuss OCC enforcement of section 5 of the Federal Trade Commission Act for consumer protection purposes.

⁵68 Fed. Reg. 46119, 46120 (Aug. 5, 2003).

⁶The complex system of federally and state-chartered banks is generally referred to as the "dual banking system."

Finally, Members of Congress held three hearings in 2004, including one held by your subcommittee in January of that year, centered on these and other issues. In addition to airing differences on the limits of federal versus state powers and potential effects on consumers, the hearings also featured discussion about such issues as why OCC issued the rules when Congress was in recess (after receiving a request from some members to delay the issuance of the rules), to what extent OCC consulted with state officials and other groups during the rulemaking process, and the resources OCC dedicates to consumer complaints.

The statutory framework applicable to OCC rulemaking includes the Administrative Procedure Act (APA), which, among other things, sets forth the process for federal agency “informal rulemaking”; the Congressional Review Act (CRA), which provides for Congress’s review of an agency’s rules and even disapproval (through a joint resolution); the Regulatory Flexibility Act (RFA), which requires agencies to assess the economic impact of their proposed rules on “small entities”;⁷ and the Unfunded Mandates Reform Act (UMRA), which generally requires covered agencies to take certain actions if their proposed rules could result in the expenditure of \$100 million or more in any year by state, local, and tribal governments, or by the private sector. In addition, OCC is subject to executive orders in its rulemakings. Executive Order 12866, Regulatory Planning and Review (E.O. 12866) directs agencies, among other matters, to determine if their proposed rules constitute a “significant regulatory action” as that phrase is defined in the order, and, if so, to prepare certain analyses and provide them to the Office of Management and Budget (OMB), which is charged with reviewing agencies’ proposed rules under the order. A second order, Executive Order 13132, entitled “Federalism” (E.O. 13132), sets forth principles, policymaking criteria, and requirements for agencies to apply when developing “policies that have federalism implications.” Federalism in this context means the division of government responsibilities between the federal government and the states. The APA, other laws, and the two executive orders give agencies discretion about how to promulgate regulations.

You requested that we review the process OCC followed in promulgating the preemption rules; assess the potential impact of the rules on the dual banking system and consumer protection; and assess OCC’s process and

⁷“Small entities” includes small businesses, small governmental jurisdictions, and certain not-for-profit organizations. 5 U.S.C. § 601-612.

capacity to handle consumer complaints. As agreed with your staffs, we will provide you with separate reports on the potential impact of these rules on the dual banking system and OCC's capacity to handle consumer complaints at a later date. This report focuses on OCC's rulemaking process. Accordingly, the report (1) assesses OCC's rulemaking process within the framework of applicable laws and executive orders; (2) describes the issues raised in public comment letters on the banking activities rule, and describes if and how OCC responded to these comments; and (3) identifies issues that stakeholders raised about the manner in which OCC promulgated its preemption rules and how OCC responded to the stakeholders.

To assess OCC's rulemaking process, we reviewed applicable laws and executive orders related to OCC rulemaking and analyzed the *Federal Register* notices pertaining to both the proposed and final preemption rules. In addition, we interviewed OCC officials who participated in OCC's promulgation of the rules and analyzed the documents from docket files that OCC maintained on the two rules. Using this information, we compared OCC's actions with the provisions of the relevant laws and executive orders. To determine the issues raised in the comment letters on the substance of the banking activities rule, we conducted a content analysis of 373 letters received by the OCC on its preemption proposal. To describe how OCC responded to the issues raised in the comment letters, we analyzed the final rule for any changes OCC attributed to the comments and the preamble of the final rule for discussion regarding the public comments. To clarify our understanding of how OCC considered or addressed certain comments, we interviewed OCC officials. To identify issues raised about how OCC promulgated its preemption rules, we interviewed officials from consumer groups and state organizations to obtain their views and reviewed statements and transcripts from congressional hearings and letters that members sent to OCC during the public comment period. To identify how OCC responded to the criticisms of its rulemaking process, we interviewed OCC officials and reviewed their congressional testimony. In addition, we interviewed officials from the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC) to obtain information on how those organizations handle controversial rules. We conducted our work in Washington, D.C., from August 2004 through August 2005 in accordance with generally accepted government auditing standards. Appendix I provides a detailed description of our scope and methodology.

Results in Brief

OCC followed the statutory framework for rulemaking and appears to have acted within its discretion in executing the executive orders, but we could not fully determine the basis for some of the other agency actions or assess the extent of its consultations with stakeholders, because OCC did not always document its actions and lacked written guidance and procedures detailing the rulemaking process. OCC followed the process for informal rulemaking set forth in the APA by allowing for public participation through the “notice and comment process.” That is, OCC published both the visitorial powers and banking activities proposals in the *Federal Register*, requested and considered public comments, and promulgated the final rules as prescribed by the APA. OCC also followed requirements and documented some actions it took related to the other statutes. However, with regard to the two executive orders, OCC did not always document its actions and some stakeholders disputed some of OCC’s decisions or actions related to both orders. For example, in the preamble to the banking activities rule, OCC stated that the rule was not “significant” for purposes of E.O. 12866. Staff memorandums, in the official rulemaking file, which we reviewed, did not articulate the analysis underlying the determination. OCC officials told us that because the rules were clarifying matters related to the powers of national banks that had been addressed previously by OCC and in court decisions, they did not deem the rules to be significant regulatory actions as defined in the order. In relation to provisions of E.O. 13132 that direct agencies to consult with state and local officials early in the process of rulemaking when preemption of state law is involved, some state bank supervisors, attorneys general, and their representative organizations maintain that OCC’s efforts to consult with them were not sufficient. OCC disagreed with those views. Its official rulemaking file contained little to document its consultation efforts. Further, OCC does not have written guidance, policies, or procedures detailing the rulemaking process. Instead, OCC uses a “rulemaking checklist” that serves as a guide for completing the required reviews and the routing of documents. According to internal control standards for the federal government, agencies should follow written procedures in making important decisions. Without such documentation, it may not be clear—to agency management, auditors, or oversight committees—that an agency followed applicable requirements.

While OCC considered the comments it received in response to its banking activities proposal, it disagreed with challenges to its preemptive authority. However, OCC did make changes in the final rule in response to some commenter concerns. OCC considered all of the approximately 2,700 comment letters submitted by a variety of consumer groups, public

officials, businesspeople, and others in response to its banking activities proposal. Our analysis of the 373 nonform comment letters revealed that commenters focused on what they believed would be the rule’s diminishing effect on enforcement of state consumer protection laws, questions about OCC’s legal analysis and conclusions justifying preemption and the rule’s effect on the dual banking system. Consumer groups commented that because national banks and their subsidiaries would no longer be subject to state consumer protection laws, some of which have “higher standards” than federal law, consumers would be vulnerable to predatory lending. Some consumer groups and state officials with whom we met continue to believe that there is a “vacuum” in consumer protection under the rule. Opposing comments also disputed OCC’s legal authority to preempt a state’s right to regulate entities organized under its law, such as operating subsidiaries of national banks. OCC’s consideration of comments is reflected in various documents, including the preamble to the final rule, and internal memorandums. While OCC considered the comments, it disagreed with several commenters, particularly those who questioned its ability to protect consumers and challenged its authority to promulgate its rule. However, OCC agreed with some issues raised in the comments and made some changes to the final banking activities rule. For instance, several consumer groups urged OCC to state that national bank lending practices should conform to the Federal Trade Commission Act’s prohibition against unfair or deceptive acts or practices. OCC agreed and added this language to the final rule. OCC noted that this addition augmented standards it set previously in 2003 guidance for banks regarding predatory lending.⁸ In addition, since the rule was finalized, OCC has issued guidance to national banks on avoiding predatory, abusive, unfair, or deceptive lending practices.⁹

Most criticism of OCC’s rulemaking procedures—which came from consumer groups, some state officials and their respective organizations, some Members of Congress, and others—focused on what some believed was a lack of opportunity to discuss and comment on the proposed rules and OCC’s issuance of the final rules when some Members of Congress had asked for a delay. According to OCC, it provided ample opportunity for

⁸OCC Advisory Letter 2003-2, “Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices” (Feb. 21, 2003) and OCC Advisory Letter 2003-3, “Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans” (Feb. 21, 2003).

⁹70 Fed. Reg. 6329 (Feb. 7, 2005).

comment, especially since the rules were not “new law,” but reflected precedents and standards already applied by OCC or courts. Although OCC briefed several Members of Congress about the rules before they were issued, some criticized OCC for issuing the rules while Congress was out of session and not allowing additional time for congressional hearings about many issues raised by the proposed rules. From OCC’s perspective, the length of the delay that some members were requesting was unclear and other members did not endorse a delay. According to OCC officials, a lengthy delay would have created more uncertainty for national banks regarding the applicability of state or local laws and could have led some lenders to stop lending in certain markets because of variations in state or local laws, challenges in complying with them, and difficulties in selling loans made under state and local laws. Consumer groups we interviewed also suggested that OCC should have offered additional mechanisms for soliciting public input in its rulemaking. Other financial institution regulators have used additional mechanisms for public comment when they deemed rulemakings controversial. For example, some had used “public meeting type” hearings. According to OCC officials, they did not take such actions because they believed that they fully understood the points of view of all stakeholders. Measures such as public meetings might have promoted greater understanding of the preemption rules and provided opportunities for building more constructive relationships between federal and state authorities.

We provided a draft of this report to OCC for review and comment. In written comments, the Comptroller of the Currency (see app. II) concurred with our observation that its rulemaking process could benefit from detailed written rulemaking procedures and the agency intends to develop them by year-end 2005. OCC disagreed with our observation that its documentation did not articulate the analysis underlying its conclusion that the rules were “not significant” for purposes of E.O. 12866. We examined OCC’s documentation and found it consisted of stating that the rules were not a significant regulatory action as defined by the executive order because the annual effect on the economy was less than \$100 million. However, OCC’s documentation did not address other criteria set forth in the order, such as whether a rule would have an adverse effect in a material way on state, local, or tribal governments or communities. Thus, we continue to disagree with OCC. Although OCC maintained that its efforts to consult with state officials and organizations were appropriate for the preemption rulemakings, it intends to enhance those efforts. OCC also provided technical comments that we incorporated, as appropriate.

Background

The federal agency rulemaking process is subject to statutory requirements and executive orders issued by the President. Summaries or brief discussions of OCC's mission and program areas (including regulation), the statutes and executive orders pertaining to rulemaking, and the legal basis for preemption follow.

OCC Mission and Regulatory Responsibilities

OCC's mission focuses on the chartering and oversight of national banks to assure their safety and soundness and on fair access to financial services and fair treatment of bank customers. OCC is one of five federal regulators of institutions whose deposits are federally insured—the other four are the Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA). While the Federal Reserve and FDIC share supervision of state-chartered banks with the states, OCC is the sole supervisor for national banks. OTS oversees thrifts or savings and loan institutions and NCUA oversees credit unions and insures the member deposits at federally insured credit unions.

OCC groups its regulatory responsibilities into three program areas: chartering, regulation, and supervision. Chartering activities include not only review and approval of charters, but also review and approval of mergers, acquisitions, and reorganizations. Regulatory activities result in the establishment of regulations, policies, operating guidance, interpretations, and examination policies and handbooks. OCC's supervisory activities encompass bank examinations and enforcement activities; dispute resolution; ongoing monitoring of banks; and analysis of systemic risk and market trends. Additionally, in its most recent strategic plan, OCC identified its regulatory approach as one that would ensure that national banks operated in a "flexible legal and regulatory framework" that enables them to provide a "full competitive array" of financial services. The plan also included fair access to financial services and fair treatment of bank customers as a strategic goal. The agency also emphasized that it would "support continued recognition of the preemptive attributes of the national bank charter through appropriate opinions, regulations, and participation in litigation where warranted."

As of March 2005, the assets of the banks that OCC supervises account for approximately 67 percent—about \$5.8 trillion—of assets in commercial banks. Among the more than 1,800 banks OCC supervises are 14 of the top

20 commercial banks in asset size. OCC also supervises federal branches and agencies of foreign banks.

Statutory Rulemaking Requirements

Section 553 of the Administrative Procedure Act (APA) contains requirements for the most long-standing and broadly applicable type of federal rulemaking, commonly referred to as “informal rulemaking” or “notice and comment” rulemaking.¹⁰ Most federal rulemaking is conducted as informal rulemaking, in which agencies publish a notice of proposed rulemaking in the *Federal Register* and provide “interested persons” with an opportunity to comment on the proposed rule.¹¹ The act does not specify the length of the comment period, but agencies commonly provide at least 30 days. The act does not mandate that an agency hold oral, or “public meeting type,” hearings during the comment period for informal rulemaking; instead, it allows an agency to decide whether to hold a hearing.¹² After giving interested persons an opportunity to comment on the proposed rule, and after considering the public comments, the agency may then publish the final rule, incorporating a general statement of its basis and purpose.¹³ The APA’s notice and comment procedures do not apply to interpretative rules; general statements of policy; or rules that deal with agency organization, procedure, or practice.

The Congressional Review Act (CRA) allows Congress to review proposed federal regulations and also contains provisions by which Congress may

¹⁰The APA also contains requirements for formal rulemaking, which is used in rate-making proceedings and in other cases where statute requires that rules be made “on the record.” Formal rulemaking incorporates evidentiary (or “trial type”) hearings, in which interested parties may present evidence, conduct cross-examinations of other witnesses, and submit rebuttal evidence. However, few statutes require such on-the-record hearings.

¹¹5 U.S.C. § 553 (2000). The notice is to contain (1) a statement of the time, place, and nature of public rulemaking proceedings; (2) reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

¹²5 U.S.C. § 553 (c). As noted later in this report, by following APA procedures and allowing for a comment period of more than 30 days, OCC also followed the procedures for preemptive interpretative rules contained in 12 U.S.C. § 43.

¹³The act states that the rule cannot become effective until at least 30 days after its publication unless (1) the rule grants or recognizes an exemption or relieves a restriction, (2) the rule is an interpretative rule or a statement of federal rulemaking policy, or (3) the agency determines that the rule should take effect sooner for good cause and publish that determination with the rule.

disapprove agency rules.¹⁴ Before any final rule can become effective, CRA requires that it be filed with each house of Congress and us. The act also requires federal agencies to submit to us and make available to each house of Congress a copy of any cost-benefit analysis prepared for the rule. If the rule is designated by OMB's Office of Information and Regulatory Affairs as "major" (that is, having a \$100 million impact on the economy or having another characteristic contained in the act), the agency must delay the rule's effective date by 60 days after publication in the *Federal Register* or submission to Congress and us, whichever is later.¹⁵ Within 15 days of receiving a major rule, we are required to provide Congress with a report assessing the agency's compliance with various acts and executive orders applicable to the rulemaking process. Finally, under CRA, congressional members can introduce a joint resolution of disapproval for any rule regardless of whether it is designated as major. To date, Congress has issued such a resolution only once—by disapproving the Occupational Safety and Health Administration's ergonomics standards in 2001.¹⁶

The Regulatory Flexibility Act of 1980 (RFA) generally requires federal agencies to assess the impact of their regulation on "small entities," including businesses, governmental jurisdictions, and certain not-for profit organizations having characteristics set forth in the act.¹⁷ Under RFA, Cabinet departments and independent agencies generally must prepare a "regulatory flexibility analysis" in connection with proposed and certain final rules, unless the head of the issuing agency determines that the proposed rule would not have a "significant economic impact" upon a substantial number of small entities. The analysis must include, among other things, (1) the reasons why the regulatory action is being considered; (2) the small entities to which the proposed rule will apply and, where

¹⁴5 U.S.C. §§ 801-808.

¹⁵A major rule is defined as a rule that will likely have an annual effect on the economy of \$100 million or more; increase costs or prices for consumers, industries, or state and local governments; or have significant adverse effects on the economy.

¹⁶On November 14, 2000, the Occupational and Safety Health Administration promulgated an ergonomics standard. It would have required employers to set up control programs for job categories where "work-related musculoskeletal disorders" are reported. In the debate over ergonomics, large monetary estimates have been cited for both the benefits of a national standard and the costs thereof. After the final standard was released in November 2000, opponents of the Occupational Safety and Health Administration's approach introduced and quickly passed a congressional resolution of disapproval that revoked the rule.

¹⁷5 U.S.C. §§ 601-612.

feasible, an estimate of their numbers; and (3) the projected reporting, record keeping, and other compliance requirements of the proposed rule.

Congress enacted the Unfunded Mandates Reform Act of 1995 (UMRA) to reduce the costs associated with federal imposition of responsibilities, duties, and regulations upon state, local, and tribal governments, and the private sector. Title II of the act generally requires covered federal agencies to prepare a written statement containing specific information about costs and benefits for any published rule that includes a federal mandate that may result in expenditures by state, local, and tribal governments (in the aggregate) or the private sector of \$100 million or more in any year.

Executive Orders on Rulemaking

In addition to statutory requirements, certain agencies, including OCC, are subject to Executive Order 12866, “Regulatory Planning and Review” (E.O. 12866) and Executive Order 13132, “Federalism” (E.O. 13132). Under E.O. 12866, issued in 1993, covered agencies must submit their “significant” rules to the Office of Management and Budget (OMB) before publishing them in the *Federal Register*.¹⁸ Agencies also are required to prepare a detailed economic analysis for any regulatory actions that are “economically significant” (that is, have an annual effect on the economy of \$100 million or more or have a material adverse effect as described in the order). The analysis should include an assessment of anticipated costs and benefits of the action as well as the costs and benefits of “potentially effective and reasonably feasible alternatives.” In choosing among alternatives, an agency should select approaches that maximize benefits, and base its decision on the best “reasonably obtainable” information. In 1996, OMB issued “best practices” guidance on preparing cost-benefit analyses under the order, which gives agencies substantial flexibility on preparing the analyses, but also prescribes certain elements and requires that the analysis be “transparent”—that is, that an agency disclose how it conducted the study, what assumptions it used, and what the implications of plausible alternative assumptions are.

¹⁸GAO, *Rulemaking: OMB's Role in Reviews of Agencies' Draft Rules and the Transparency of Those Reviews*, GAO-03-929 (Washington, D.C.: Sept. 22, 2003), 24. Before the issuance of E.O. 12866, OMB reviewed all proposed federal rules. Subsequently, OMB reviewed only significant rules and the number of regulations reviewed annually declined from 2,000-3,000 to 500-700.

Executive Order 13132 addresses the division of governmental responsibilities between the national government and the states as envisioned by the framers of the Constitution. The order contains principles, policymaking criteria, and requirements for agencies to apply and follow when formulating “policies that have federalism implications,” which are defined to include “regulations . . . and other policy statements or actions that have substantial direct effects on the States, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government.” The order includes special requirements for agency actions that preempt state law. Also, E.O. 13132 specifies that rulemaking that has federalism implications be conducted through an “accountable process” and ensure “meaningful and timely” input by state and local officials. Further, the order directs the agency to provide to the Director of OMB a federalism summary impact statement, which would include: (1) a description of the extent of the agency’s prior consultation with state and local officials, (2) a summary of the nature of their concerns, (3) the agency’s position supporting the need to issue the regulation, and (4) a statement of the extent to which the concerns of state and local offices have been met.

Legal Basis for Preemption

Preemption of state law is rooted in the Constitution’s Supremacy Clause, which provides that federal law is the “supreme law of the land.” Because both the federal and state governments have roles in regulating financial institutions, questions can arise about whether the governing federal statute preempts particular state laws. Analysis of whether federal law preempts state law has turned on whether Congress intended that federal law overrides state law. Courts traditionally have divided preemption analysis into categories of “express” and “implied” preemptions.

At times, Congress may declare in express terms its intention to preclude or override state regulation in a given area. With an express preemption, Congress’s intent to preempt state law is clear in the statute. In addition to express preemption, preemption may be implied from the federal statute’s structure and purpose. Courts have identified two types of implied preemptions: “field preemptions” and “conflict preemptions.” In the case of field preemption, a court basically finds that the federal government has so “occupied the field” in a given area that there is no room for state legislation. Conflict preemption occurs when a court concludes that state law is in irreconcilable conflict with federal law. In these instances, a court finds that while Congress did not intend necessarily to preempt state

regulation in a given area, state law that conflicts directly with federal law or stands as an obstacle to the accomplishment of federal objectives is preempted.¹⁹

Before the promulgation of its preemption rules, OCC primarily addressed preemption issues through opinion letters, issued in response to a specific inquiry from an institution or state.²⁰ In 2000, we examined OCC's authority and approaches in preempting state laws.²¹ We reported that OCC, applying conflict preemption analysis, issued interpretations of whether federal laws preempt state laws in opinions and corporate decisions. In the opinions and decisions it issued, prior to January 2004, particularly in the area of making loans and taking deposits, the Comptroller maintained consistently that state laws that conflict with national bank powers authorized under the National Bank Act are preempted. Additionally, OCC's opinions, based on regulations, on real estate lending specifically preempted state laws in five areas relating to certain loan terms and conditions, and stated that OCC would apply "recognized principles of federal preemption" when considering whether state laws apply to other aspects of real estate lending by national banks.²²

¹⁹*Jones v. Rath Packing Co.*, 430 U.S. 519, 525-526 (1977).

²⁰See, e.g., 1978 OCC Letter No. 61 (Sept. 11, 1978), Ref. No. L31, 1978 OCC Ltr. Lexis 57 (preemption under the National Bank Act involves conflict analysis necessitating separate and individual review of all provisions of state redlining law; provisions of state law spelling out certain requirements with respect to national bank's credit terms and policies not preempted, but related reporting and investigation provisions preempted based on OCC visitorial powers authority); 1985 OCC Unpublished Interpretive Letter 122 (July 19, 1985) (because national banks have specific and independent authority under federal law to make real estate loans, licensing requirements of state law governing secondary mortgage loans were preempted with respect to national bank); 1993 OCC Ltr. No. 616 (February 26, 1993), 1993 OCC Lexis 10 (state statute requiring credit card issuers to provide information to state supervisor is a form of visitation preempted by OCC visitorial powers authority).

²¹GAO, *Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law*, [GAO/GGD/OGC-00-51R](#) (Washington, D.C.: Feb. 7, 2000).

²²See, e.g., 12 C.F.R. § 34.4 (2003). The five areas of state law specifically subjected to preemption related to: (1) the amount of a loan in relation to the appraised value of the real estate, (2) the schedule for the repayment of principal and interest, (3) the term to maturity of the loan, (4) the aggregate amount of funds that may be loaned upon the security of real estate, and (5) the covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan.

OCC Generally Followed Rulemaking Requirements but Lacked Documentation and Written Guidance, Making It Hard to Verify Consultation Efforts

OCC followed the statutory framework in conducting its preemption rulemaking, but we found it difficult to assess some of the other actions it took in the rulemaking, particularly consultations with the states, because OCC did not always document its actions and had no written guidance or procedures detailing the rulemaking process. In conducting its rulemaking, OCC followed the requirements of the APA, CRA, RFA, and UMRA. OCC also is subject to both Executive Orders 12866 and 13132, and designated both preemption rules as “not significant” for purposes of Executive Order 12866, but staff memorandums, in the rulemaking files, did not articulate the analysis underlying the determination. We also found that the lack of substantive documentation about OCC’s consultation with stakeholders made it difficult to verify whether OCC helped ensure “meaningful and timely input” by state and local officials. Further, while OCC staff used a checklist to document completion of internal reviews and ensure that documents were routed properly, OCC did not have written guidance to follow in conducting the rulemaking process. Moreover, OCC did not document the substance of its consultation with states or with other OCC offices. In contrast, other federal agencies with missions similar to OCC’s have developed some rulemaking guidance for their staffs to follow.

OCC Followed the Administrative Procedure Act in Its Rulemaking

In promulgating both the visitorial powers and banking activities rules, OCC followed the process for informal rulemaking prescribed in the APA.²³ In the preambles to the visitorial powers and banking activities proposals and final rules, OCC described the rulemakings as “clarifications” of interpretations of the scope and preemptive effect of the pertinent

²³The preemptive aspects of the rules express OCC’s interpretation of the National Bank Act. APA informal rulemaking requirements do not apply to interpretative rules. Because OCC used APA rulemaking procedures, we did not analyze whether those rules were interpretative for purposes of the APA. OCC, by following APA procedures and allowing a comment period of more than 30 days, also followed the requirements for preemptive interpretive rules under 12 U.S.C. §43.

provisions of the National Bank Act and not as “new law.”²⁴ However, OCC followed APA procedures for informal rulemaking by providing notice of the proposed rules and an opportunity for public comment, and also doubled the traditional 30-day comment period to 60 days and satisfied other requirements of the act, including consideration and discussion of comments on the rule, as we discuss later in this report. The visitorial powers proposal was published in the *Federal Register* on February 7, 2003, and OCC requested receipt of comments by April 8, 2003. The banking activities proposal was published on August 5, 2003, and OCC requested receipt of comments by October 6, 2003. Final drafts of both rules were published on January 13, 2004, with an effective date of February 12, 2004.

OCC Followed Other Laws

OCC also followed the provisions of CRA, RFA, and UMRA. Pursuant to the CRA, OCC sent copies of the final preemption rules to both houses of Congress and to our Office of General Counsel on January 7, 2004, prior to their effective date of February 12, 2004. Further, OMB did not make a determination that the rules were major rules for purposes of the CRA. It based its decision on OCC’s determination that neither rule would have a significant impact on the economy.

As described previously, the purposes of CRA include providing Members of Congress with an opportunity to disapprove of an agency rulemaking by enacting a joint resolution. In the 108th Congress, one senator and one representative introduced such a resolution to disapprove OCC’s preemption rules. More specifically, House of Representatives bill 4236 and Senate Joint Resolution 31 provided for congressional disapproval of certain regulations issued by OCC. The House resolution with 35 co-sponsors, was referred to the Subcommittee on Financial Institutions

²⁴68 Fed. Reg. 6363, 6366-67 (Feb. 7, 2003) (Proposed visitorial powers rules “interpret and implement 12 U.S.C. § 484. . . . This rulemaking contains amendments to (OCC Regulation) § 7.400 to clarify the application of section 484 to” questions about the scope of OCC’s visitorial powers in two broad categories.); 69 Fed. Reg. at 1895 - 96 (Jan. 13, 2004) (Final visitorial powers rule changes “serve to clarify that Federal law commits the supervision of national banks’ Federally authorized banking business exclusively to OCC. . . . The regulatory proposal and the final regulation would not have the effect of preempting substantive state laws, but rather would clarify the appropriate agency for enforcing those state laws that are applicable to national banks. . . . The proposal and this final rule interpret the text of a Federal statute, 12 U.S.C. § 484. . . .”); 68 Fed. Reg. 46119 (Jan. 13, 2004) (Final banking activities preemption rules “add provisions clarifying the applicability of state law to national banks’ operations.”).

and Consumer Credit of the House Financial Services Committee. The Senate resolution, with three co-sponsors, was referred to the Senate Committee on Banking, Housing and Urban Affairs. However, neither resolution garnered enough support to pass out of the respective committees.

OCC staff determined that the preemption rulemakings were not subject to the regulatory flexibility analysis (essentially, potential economic impact on small entities) required by RFA. OCC certified that no such impact would result from its rulemakings and provided the required statement in the preamble to its rules. We reviewed memorandums contained in the files that discussed OCC's consideration of RFA requirements. In an initial memorandum on each proposal, OCC's Policy Analysis Division concluded that the preemption proposals did not impose any new requirements or burdens on small entities and that the proposal would not have a significant economic impact on a substantial number of small entities. In a memorandum prepared on each proposal after the public comment period, Policy Analysis Division staff concluded that neither individual consumers nor state governments could be considered to be small businesses, small organizations, or small governmental jurisdictions under RFA and, therefore, OCC need not consider the impact of its final rule on consumers or state governments under RFA.

Similarly, OCC determined that, under UMRA, it did not need to prepare a written statement during rulemaking, because neither rule would result in expenditures by state, local, or tribal governments (in the aggregate), or by the private sector, of \$100 million or more in any year. OCC also stated this position in the preamble of each rule. In a memorandum related to the visitorial powers proposal that was written before the comment period, an OCC official wrote that the rule "would be permissive rather than restrictive and certain provisions permit banks to reorganize in more cost-effective ways than is currently the case." The memorandum concluded that private-sector costs associated with the proposed rule would be below the \$100 million threshold in UMRA. In a memorandum on the banking activities proposal, drafted both before and after the public comment period, OCC staff concluded that analyses for purposes of UMRA were not necessary because the rules would not result in expenditures totaling \$100 million or more.

OCC Appears to Have Followed Some Provisions of the Executive Orders, but Its Consultation with the States, a Provision of the Order on Federalism, Appears Limited

Two executive orders pertained to OCC's preemption rules. E.O. 12866 directs federal agencies to determine whether rules would be "significant" and thus require OMB review. OCC sent a notice to OMB regarding the proposed preemption rules stating that the rules did not constitute significant regulatory actions under this executive order. OCC officials told us that almost all of OCC's rules are designated as nonsignificant. Further, OCC stated that because the preemption rules would clarify already existing standards under the National Bank Act, the regulations were nonsignificant for purposes of E.O. 12866. While we do not necessarily dispute this determination, we found little support for the underlying rationale the agency followed in making its decision.

Executive Order 13132, entitled "Federalism," which was issued in 1999, establishes principles and criteria for agencies to follow when formulating regulatory policies with federalism implications.²⁵ The order defines these policies as including regulations that have "substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government."²⁶ Under the order, agencies must have an "accountable process to ensure meaningful and timely input by state and local officials in the development of [such] regulatory policies."²⁷ The head of each agency is to designate an official, who will have primary responsibility for ensuring that the agency implements the order, and the official is to submit to OMB a description of the agency's consultation process.²⁸

E.O. 13132 creates special requirements for rules with federalism implications that preempt state law. When an agency foresees the

²⁵This executive order is the successor to E.O. 12612, issued in 1987. The Reagan administration's executive order was the first to establish the policy of the Executive Branch on federalism. Former President Clinton issued a new executive order on federalism in May 1998, but withdrew the order after it received criticism from state and local interests. The 1999 order was issued after negotiations between state leaders and the Clinton administration. See Jennie H. Blake, *Presidential Power Grab or Pure State Might? A Modern Debate Over Executive Interpretations On Federalism*, 2000 B.Y.U. L. Rev. 293 (2000).

²⁶Exec. Order No. 13132.

²⁷Id. at section 6(a).

²⁸Id. at section 6(a).

possibility of a conflict between state law and federally protected interests within its area of regulatory responsibility, the agency is to “consult, to the extent practicable with appropriate state and local officials in an effort to avoid such a conflict.”²⁹ If an agency proposes to act through rulemaking to preempt state law, the agency “shall provide all affected state and local officials notice and an opportunity for appropriate participation in the proceedings.”³⁰ “To the extent practicable and permitted by law, no agency shall promulgate any regulation that has federalism implications and that preempts state law, unless the agency, prior to the formal promulgation of the regulation, . . . consulted with state and local officials early in the process of developing the proposed regulation.”³¹ The order also requires agencies to submit to OMB a federalism summary impact statement in a separately identified portion of the preamble to the regulation, as it is to be published in the *Federal Register*. The federalism summary impact statement is to include a description of the agency’s prior consultation with state and local officials, a summary of the nature of their concerns, the agency’s position supporting the need to issue the regulation, and a statement of the extent to which the concerns of state and local officials have been met.³² In addition, the agency is to make available to OMB any written communications submitted to the agency by state and local officials.³³ Finally, in transmitting any draft regulation to OMB, the agency is to include a certification from the designated federalism official stating that the requirements of the order have been met in a meaningful and timely manner.³⁴

General guidance exists to aid agencies in interpretation of the requirements of the order, including the consultation requirement and the special requirements for preemption. OMB issued guidance for heads of agencies in implementing E.O. 13132, describing what agencies should do to comply with E.O. 13132 and how they should document that compliance

²⁹Id. at section 4(d).

³⁰Id. at section 4(e).

³¹Id. at section 6(c)(1).

³²Id. at section 6(c)(2).

³³Id. at section 6(c)(3).

³⁴Id. at section 8(a).

for OMB.³⁵ In connection with the consultation requirement, the guidance provides that agencies “should seek comment on . . . preemption as appropriate to the nature of the rulemaking under development. The timing, nature, and detail of the consultation should also be appropriate to the nature of the regulation involved.”³⁶

After the issuance of E.O. 13132, OCC sent a letter on September 17, 1999, to the Conference of State Bank Supervisors (CSBS) proposing a process by which it would consult with the state bank regulators.³⁷ First, OCC asked that CSBS serve as the primary channel for communicating with state banking officials when OCC proposed a regulation that had federalism implications. Secondly, it proposed to send CSBS the draft of a proposed regulation shortly before the document was sent to the *Federal Register* for publication. According to OCC, CSBS would still have sufficient time within a rulemaking comment period to distribute the draft to its members and receive comments. OCC stated that these comments would receive special review in the context of the federalism implications of the proposal in question. In response, the CSBS President agreed to act as an intermediary between OCC and various state banking departments on policy issues that might affect state rulemaking and supervisory authority.

Although OCC did send the drafts of the proposed rules to CSBS, the extent to which it consulted with state officials appeared limited. Following publication of the proposed rules, OCC indicated it met twice with CSBS representatives. OCC officials offered several reasons why, in their view, additional consultation with the states was unnecessary or impracticable. They told us that OCC maintained a channel of informal communication with CSBS during the period leading up to the rules and, through this mechanism, was informed about state concerns, as contemplated by the order. In attempting to verify OCC’s established consultation process with CSBS, we found that OCC sent letters to CSBS regarding both the visitorial powers and the banking activities rules, in which OCC advised CSBS of the publication of the proposals. For both proposals, OCC sent the letters a few

³⁵See OMB, *Memorandum for Heads of Executive Departments and Agencies, and Independent Regulatory Agencies: Guidance for Implementing E.O. 13132*, from John T. Spotila, Administrator, Office of Information and Regulatory Affairs (Washington, D.C., Oct. 28, 1999).

³⁶Id. at section 8.

³⁷The Conference of State Bank Supervisors is an umbrella organization that represents the state bank regulators.

days before their publication in the *Federal Register*. OCC advised CSBS of the visitorial powers proposal on January 31, 2003, and the proposal was published on February 7, 2003. For the banking activities proposal, CSBS received notification on July 30, 2003, before the proposal was published in the *Federal Register* on August 5, 2003. OCC officials stated that because the rules codify preemption precedents, they generally did not impose new or different standards and as a result, further consultation with the states was not necessary. Finally, OCC officials noted that because the rules reflect the agency's understanding of congressional intent about the preemptive effect of the National Bank Act, dialogue with the states about their role in regulating national banks and their subsidiaries would not have raised issues about which OCC was not already aware.

The OMB guidance strongly recommends that, to the extent that an agency has carried out intergovernmental consultations prior to publication of the Notice of Proposed Rulemaking, the agency help state and local governments, and the public as a whole, by including a "federalism summary impact statement" in the preamble to the Notice of Proposed Rulemaking.³⁸ Although OCC itself has issued no guidance to assist in determining whether a proposed regulation has sufficient federalism implications to warrant preparation of a federalism summary impact statement, OCC drafted and provided to the Director of OMB the federalism summary impact statements. The impact statements included information on OCC's consultation efforts with the states on both rules, the concerns of the states, and the extent to which the concerns were addressed. As required by the executive order, OCC included the impact statements, as part of the preambles of the preemption rules. The content of the two impact statements was similar. In providing these materials to OMB, OCC certified its compliance with the order. However, we found minimal documentation in OCC files related to the federalism summary impact statement provision of E.O. 13132. We could determine that OCC sent the federalism summary impact statement to OMB because OMB staff provided us with the documentation.

We note that there are no court decisions or other precedents applicable in determining what the executive order requires; nevertheless, OCC might have considered additional consultative actions to help ensure the meaningful and timely input by state and local officials. For example, as discussed more fully later in this report, OCC might have considered

³⁸See OMB's *Guidance for Implementing E.O. 13132*, 6.

holding additional meetings with interested parties and providing further opportunities for input by entities such as trade groups, state attorneys general, and state bank regulators. OCC also might have solicited this input by asking for written comments on policy proposals and conducting additional outreach to state officials.

While We Could Describe the General Process, All of OCC's Actions Were Not Fully Documented; Additionally, OCC Lacks Formal Guidance on Rulemaking

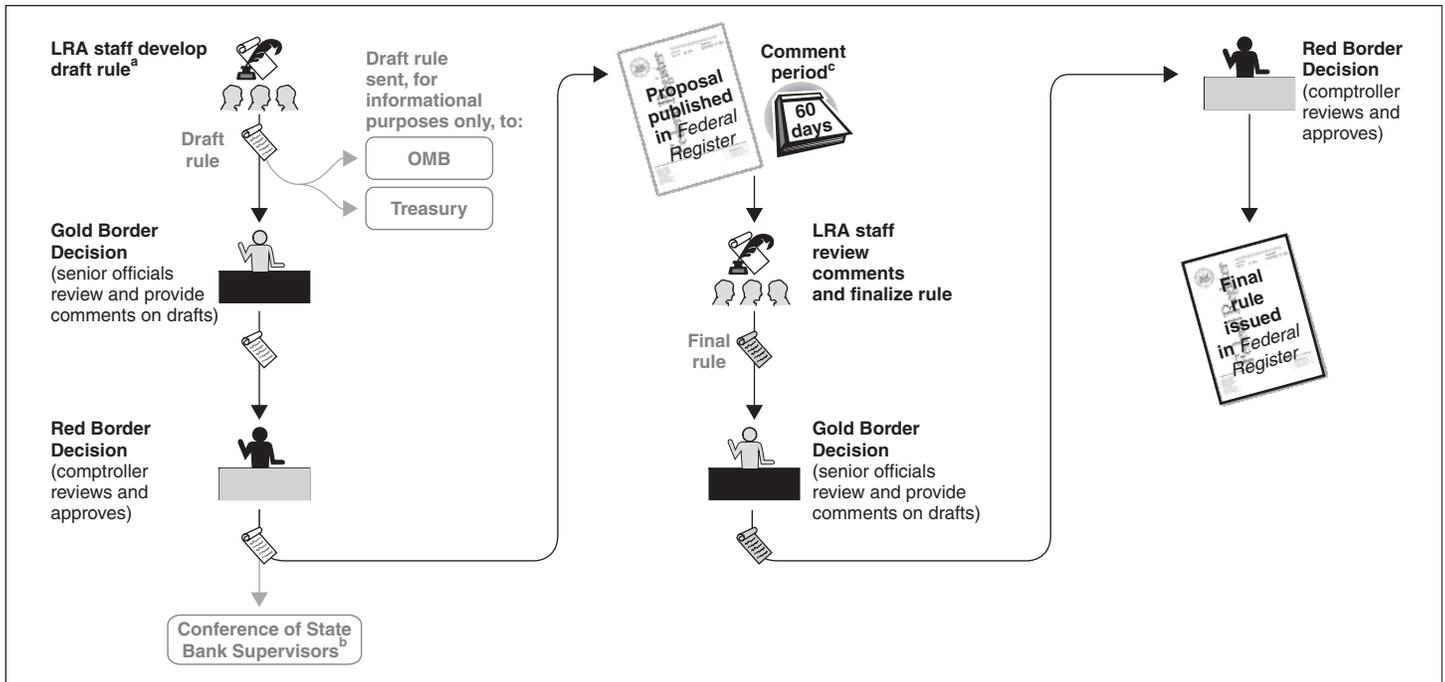
We could not verify all of the actions OCC took to complete its preemption rulemaking because OCC did not always document its actions and lacked written guidance or procedures detailing the rulemaking process. According to *Standards for Internal Control in the Federal Government*, agencies should follow written procedures in making important decisions. Absent such documentation, it may not be clear that an agency followed applicable requirements and made its decision without bias. The agency also needs operating information to determine whether it has met requirements under various laws and regulations.³⁹ Moreover, the former Administrative Conference of the United States noted, "Rulemaking is not just a product of external constraints. The agency's own processes for developing rules and reviewing them internally affect the rulemaking environment. Thus, agency management initiatives can have a significant impact on the effectiveness and efficiency of rulemaking."⁴⁰

We were able to ascertain OCC's general process for conducting a rulemaking, but had to augment our review of the docket files for the preemption rules with interviews of OCC officials. Figure 1 illustrates the various stages of approval by OCC management and actions taken by OCC staff to promulgate regulations. More specifically, the staff of the Legislative and Regulatory Activities Division (LRA) is primarily responsible for drafting and managing OCC's rulemaking. The process includes various levels of internal review and approval; additionally, OCC submits draft proposals to Treasury for informational purposes and to OMB to fulfill their responsibility under the executive order.

³⁹GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C: November 1999), which was prepared to fulfill our statutory requirement under the Federal Managers' Financial Integrity Act of 1982, provides an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

⁴⁰Jeffrey Lubbers, "Administrative Conference of the United States Recommendation 93-4: Improving the Environment for Agency Rulemaking," *A Guide to Federal Agency Rulemaking* (Chicago: American Bar Association, 1999), 423.

Figure 1: OCC Informal Rulemaking Procedures



Source: GAO.

^aThe Legislative and Regulatory Activities Division's responsibilities include developing and drafting OCC's regulations and ensuring the agency's compliance with the various federal statutes and executive orders that govern the rulemaking process.

^bIn the case of the preemption rules, OCC sent the Conference of State Bank Supervisors the drafts of the banking activities and visitorial powers proposals on July 30, 2003, and January 31, 2003, respectively.

^cThe visitorial powers proposal was published in the *Federal Register* on February 7, 2003 (68 Fed. Reg. 6363), and the banking activities proposal was published on August 5, 2003 (68 Fed. Reg. 46119). Both proposals incorporated a 60-day comment period.

However, OCC does not have written guidance, policies, or procedures detailing the rulemaking process. As part of its general agency *Policies and Procedures Manual*, OCC includes guidance on its internal approval process for its policymaking and rulemaking. Much of the guidance focused on administrative and routing actions of OCC staff. For example, it included instructions on staff practices, such as preparing an initiation memorandum, an issues memorandum that discusses the project and summarizes the issues for OCC staff, and staff actions required for a gold border review. The guidance for the gold border review described how staff should prepare the reviewers' memorandum, identify the appropriate

reviewers, and secure the required approval signatures. During our review of the rulemaking process, OCC revised this guidance. The revised guidance, issued on April 26, 2005, provides a more in-depth discussion of the gold and red border approval processes. However, neither the previous nor revised guidance discussed how OCC staff should implement relevant rulemaking laws and executive orders when they are conducting a rulemaking.

OCC did retain some documentation related to the rulemaking in the official file, known as a “docket,” for each of the rules. In addition, the dockets contained what officials called “a rulemaking checklist.” The checklist served as a guide for completing the required reviews and the routing of documents (see fig. 2). However, based on our review, the checklist did not record the substance of any decisions made during the development and the promulgation of the rules.

Figure 2: Sample OCC Rulemaking Checklist

RULEMAKING CHECKLIST	
TITLE: _____	
TYPE OF DOCUMENT: <input type="checkbox"/> ANPRM <input type="checkbox"/> NPRM <input type="checkbox"/> FINAL RULE <input type="checkbox"/> INTERIM <input type="checkbox"/> NOTICE _____	
INTERAGENCY RULEMAKING: <input type="checkbox"/> FDIC <input type="checkbox"/> FRB <input type="checkbox"/> OTS <input type="checkbox"/> OTHER _____	
CFR PART: _____ TREASURY ID#: _____ RIN: _____	
DRAFTER & CONTACTS: _____	
DATE	ACTION
	Project initiation memo prepared
	RIN obtained
	NOPRA sent to OMB and Treasury
	OMB approved
	Issues memo prepared
	Chief Counsel approved gold border for distribution
	Gold border distributed. Comments due by:
	E-mail notification sent
	Economic impact analysis letter received
	Red border received
	Comptroller signed document. E-mail notification sent.
	Treasury approval/comments received
	E-mail notification sent
	Received Chief Counsel's approval to send to Federal Register
	Communications and contacts notified
	Document sent to Federal Register. E-mail notification sent
	Federal Register edits approved by manager, edits made
	Publication date received. E-mail notification sent
	Paperwork - Submission sent to OMB. E-mail notification sent
	E-mail notification sent
	Final rule report sent to Congress and GAO (under Small Business Regulatory Enforcement Fairness Act of 1996)
	Banking bulletin prepared
	Document published in Federal Register: E-mail notification sent.
	Federal Register Cite:
	Date comment period ends
	Effective date
	Small bank compliance guide prepared

Source: OCC.

As discussed previously, E.O. 12866 directs federal agencies to determine whether rules would be “significant” and thus require OMB review, but staff memorandums in the rulemaking files did not articulate the analysis underlying the determination—although the agency stated in the preambles to the final regulations that the rules did not constitute significant regulatory actions under this executive order. Also, with respect to E.O. 13132, “Federalism,” OCC stated that it “consulted with state and local officials . . . through the rulemaking process” and met with representatives of CSBS to clarify their understanding of the proposals.⁴¹ But we found no documents detailing OCC’s consultation with CSBS officials or the state attorneys general, and without documentation, we could not verify the extent or nature of the discussions. According to CSBS officials, they met twice with OCC officials regarding the banking activities proposal after its publication in the *Federal Register*; however, in their view, nothing of substance was discussed in the meetings. For example, the CSBS officials noted that in the second meeting, credit card issues were discussed more than anything else. We note that OCC officials described the subject matter discussed at these meetings as including the banking activities rule. A state attorney general told us that he and several other state attorneys general had met with the Comptroller and OCC’s Chief Counsel prior to the banking activities rule being issued, but the OCC docket files did not contain any documentation of these meetings.⁴² Further, we found minimal documentation in OCC files related to the federalism summary impact statement provision of E.O. 13132.

In addition to the lack of documentation related to consultation and impact statement provisions in the executive order, according to OCC officials, OCC does not have any written policies about communications with interested parties during a rulemaking. The officials added that when OCC staff meets with interested parties on a rule proposal, it urges them to draft a comment letter and include the issues discussed at the meeting in their letter.

Finally, OCC officials told us that they conferred with other divisions within OCC during the rulemaking. However, we did not find documentation on staff coordination or input on issues related to the

⁴¹69 Fed. Reg. 1903 (visitorial powers); 69 Fed. Reg. 1915 (bank activities).

⁴²After reviewing our draft, OCC staff provided us with correspondence between OCC officials and the state attorneys general that referred to the meeting.

rulemaking in the docket. For example, the officials told us that they consulted with OCC's Community and Consumer Law staff about some of the consumer protection issues being raised in the comment letters and the Customer Assistance Group on whether OCC had sufficient resources to handle any increase in consumer complaints. The docket files contained no information that reflected this consultation. What information on staff coordination the docket files did contain focused on routing actions, such as preparing documents for publication in the *Federal Register*. The dockets include memorandums between LRA and OCC's Policy Analysis Division staff discussing the Policy Analysis Division staff's assessment of RFA's and UMRA's applicability to the proposals. Other than these memorandums, the OCC files did not include any additional documentation of any analyses that were performed for CRA, RFA, and UMRA purposes. For example, OCC officials stated in a memorandum that these rules did not meet the criteria under the law without documenting the rationale for their decisions.

FDIC, Treasury, and SEC Have Written Guidance for Conducting a Rulemaking

FDIC and Treasury have written guidance for their rulemaking and SEC staff have also prepared written background materials, which the agencies use to assist their respective staffs in the promulgation of rules. Although the guidance differed in some cases, generally it summarized the relevant laws on rulemaking; identified certain actions that staff should take to comply with the laws; and discussed how public comments should be handled. In addition, the guidance instructed staff on coordinating with other staff members. However, because we did not review the rulemaking files or dockets of the other regulators, we could not determine how the agencies documented compliance with their guidance.

FDIC's guidance for rulemaking is contained in *FDIC Rules and Statements of Policy: Development and Review Guide and Handbook*, which provides information on overall processes for developing and reviewing FDIC rules and statements of policy, as well as specific procedures for meeting the statutory and other requirements of rules and

statements of policy. The handbook also includes criteria and instructions on how to comply with various laws.⁴³

The handbook has instructions that cover promulgation of regulations, from project planning to finalizing the rule. For example, it describes actions that FDIC staff should follow when preparing a regulatory impact analysis, specifying that the analysis should include an introduction, an analysis of the proposal, an analysis of an alternative, a quantitative analysis, and a conclusion. It goes on to provide more detailed guidance on how to prepare discussions of costs, benefits, impacts, risks, and quantitative analyses. In addition to procedures for complying with rulemaking laws, FDIC guidance outlined steps for staff coordination.

Treasury has developed guidance for the issuance of regulations, review of existing regulations, and preparation of regulatory agendas and plans that are governed by various statutes, executive orders, and other authorities. Treasury issued its guidance, "Preparation and Review of Regulations," in the form of a directive, which provides offices and bureaus with the guidance necessary to comply with the statutory authorities and to obtain timely departmental and administration review of regulatory documents. According to a Treasury official, its individual offices and bureaus, with the exception of the Internal Revenue Service, do not have separate rulemaking guidance. The Internal Revenue Service has its own rulemaking guidance, but also follows Treasury's guidance.

According to OCC officials, the procedures specified in the Treasury directive do not apply to OCC because OCC's regulations are not subject to clearance or approval by the department. The officials referred to a provision of the National Bank Act (12 U.S.C. § 1) that describes the Comptroller's authority and autonomy over matters within OCC's

⁴³Executive Orders 12866 and 13132 apply to agencies defined under 44 U.S.C. § 3502(1), but not to those considered independent regulatory agencies as defined in section 3502. Since FDIC is an independent regulatory agency under section 3502 and is not subject to Executive Orders 12866 and 13132, its handbook does not have any procedures on carrying out these executive orders.

jurisdiction.⁴⁴ Thus, according to OCC officials, while consultation between OCC and Treasury occurs on policy matters, the OCC's regulations are not subject to clearance or approval by Treasury. However, according to a Treasury official, the Treasury has the opportunity to review and comment on each proposed and final regulation prior to issuance.

We do not challenge the OCC officials' assertion about the applicability of Treasury's directive, but we note that the directive contains guidance useful for assessing the adequacy of opportunities for public participation and directs offices and bureaus to allow not less than 60 days for public comment on the notice for proposed rulemakings that are designated "significant." The directive also provides guidance on whether regulatory actions are significant as defined in E.O. 12866. Treasury's directive also refers to implementing orders on federalism, but refers to E.O. 12612, the predecessor of E.O. 13132; thus, we did not use it for comparative or illustrative purposes in this report. According to a Treasury official, the department is currently updating the directive.

An overview of regulatory requirements is included in the *SEC Compliance Handbook*, which was revised by its Office of the General Counsel in October 1999.⁴⁵ Based on our review, the handbook provides an overview of the relevant rulemaking statutes, such as the CRA and RFA, and other suggested steps that SEC staff should consider using in conducting a rulemaking. For example, staff should consider consulting with the General Counsel and the Office of Economic Analysis and circulating the draft to other potentially affected divisions as early as possible.

Based on our review, the handbook also describes what type of records generally should be kept for a rulemaking. It suggests that SEC staff not only include among other things internal memorandums and research, but also comment letters, a summary of comments, and Office of Economic Analysis data. Finally, SEC's handbook also discusses the regulations

⁴⁴See 12 U.S.C. § 1462a(b)(3). Among other things, the section provides that the Secretary of the Treasury may not delay or prevent the issuance of any rule or the promulgation of any regulation by the Comptroller. It also gives to the Comptroller the same authority over matters within OCC's jurisdiction as the OTS director has over matters within OTS's jurisdiction. The same authority means that the Secretary of the Treasury may not intervene in any matter or proceeding before the Comptroller (including agency enforcement actions) unless otherwise specifically provided by law.

⁴⁵Like FDIC, SEC is an independent regulatory agency under 44 U.S.C. § 3502 and, therefore, is not subject to Executive Orders 12866 and 13132.

relevant for determining whether the commission should treat a rule as major or “nonmajor” for purposes of CRA. It notes a number of documentation and coordination tasks that staff could undertake before making the designation. For example, staff members could consider: (1) preparing a short memorandum for OMB that briefly describes the rule and the reasons why the rule is not major and (2) keeping background information supporting the basis for the recommended determination.

OCC Considered All Comments on Its Banking Activities Rule, and Strongly Disagreed with Those Challenging Its Authority, but Made Some Changes in Response to Others

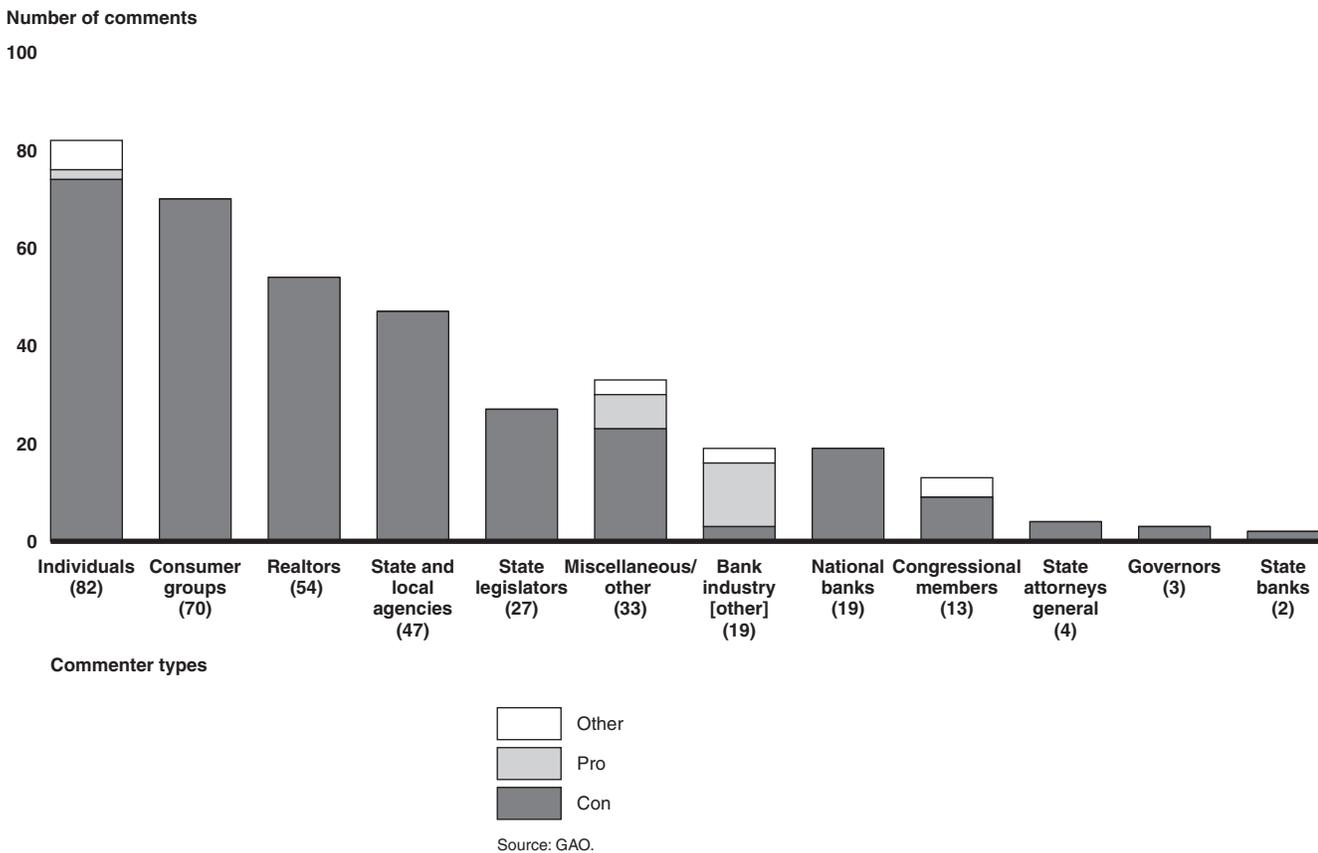
While OCC considered all public comments, it strongly disagreed with those questioning its preemption authority or the rule’s negative effects on consumers; however, it did make changes to the rule in response to some comments. OCC reviewed and considered approximately 2,700 comment letters submitted by a variety of consumer groups, public officials, businesspeople, and others in response to its banking activities proposal. Our analysis of the comment letters revealed that commenters, among other things, focused on what they believed would be the rule’s effect to diminish enforcement of state consumer protection laws, questions about OCC’s legal analysis, and conclusions justifying preemption and the rule’s effect on the dual banking system. OCC’s consideration of the comments is reflected in a number of sources, including the final rule. While OCC considered the comments, it strongly disagreed with those that challenged its ability to protect consumers and its authority to promulgate its rule. For example, OCC maintained that its banking activities rule does not affect a state’s ability to protect consumers from institutions that might engage in predatory practices but rather upholds its responsibility of ensuring the efficient operation of the national banking system as authorized by Congress, and preserves the dual banking system. However, OCC agreed with some of the comments it received and made changes to its proposed rule, including adding some information to clarify parts of the rule, such as its anti-predatory lending standard.

A Variety of Commenters Responded to the Proposed Banking Activities Rule

OCC received approximately 2,700 comments on the proposal from a variety of consumer groups, public officials, businesspeople, and other individuals. The majority of comments (83 percent) were form letters written in opposition to the proposal and submitted by Realtors and other individuals.⁴⁶ Figure 3, which is based on our analysis of 373 nonform comment letters, illustrates the composition of commenters by group and position (that is, opponent, proponent, or other). Our analysis of the content of the nonform letters indicated that 85 percent of these commenters were opposed to the proposal and expressed a variety of concerns. We found that 10 percent of the commenters favored the proposal. The remaining 5 percent of commenters neither opposed nor supported the proposal—rather, in some instances these commenters requested additional information to clarify certain aspects of the proposal.

⁴⁶We found that 2,250 comment letters submitted to OCC were form letters from Realtors and other individuals. The Realtor form letters expressed identical concerns: that national banks' financial subsidiaries would be permitted to engage in real estate brokerage activities without complying with state real estate brokerage licensing laws if the Board of Governors of the Federal Reserve were to determine that real estate brokerage is an activity permissible for qualified bank holding companies. Some individual commenters who also submitted essentially the same form letter expressed concerns about the effect of the preemption regulation on state consumer protection laws.

Figure 3: Composition of Commenters, Based on Our Analysis of 373 Nonform Letters



The Majority of the Commenters Raised Concerns about Potentially Weakening of Consumer Protections

Based on our analysis of the comment letters, we found that most commenters opposed to the proposed rule cited concerns about weakened consumer protections. These and other concerns raised in comment letters in opposition to OCC’s banking activities proposal are summarized in figure 4. They also contended that because national banks, with their considerable presence in the lending market, would no longer be subject to certain state consumer protection laws, consumers would be vulnerable to various forms of predatory lending. Comments from state officials argued that a lack of state regulation would create “an enormous vacuum of consumer protection without adequate federal regulation to fill the gap.” Many of these commenters suggested that OCC needed to do more, not less, to protect consumers. They believed that some state-enacted fair lending legislation addressed certain predatory lending practices and cited

as an example legislative efforts that mirrored the federal Home Ownership Equity Protection Act, yet provided stronger consumer protections. According to these commenters, these state laws defined and restricted high-cost loans that were more likely to be abusive or predatory and characteristic of trade practices, such as loan flipping, fee packing, and equity stripping. However, they maintained that the banking activities rule would eliminate the protections afforded by these state laws. They concluded that OCC should have refrained from preempting these state laws or, at the very least, incorporated principles from its 2003 guidance on predatory lending and abusive practices, which they argued cites some of the same fraudulent trade practices defined by these state laws and were determined by OCC to be unfair, deceptive, and likely violate the Federal Trade Commission Act. Commenters also urged OCC to affirmatively articulate that a national bank's lending practices must be conducted in conformance with section 5 of the Federal Trade Commission Act, which makes unlawful "unfair or deceptive acts or practices."

Figure 4: Frequently Cited Concerns of Selected Commenters Opposed to OCC’s Banking Activities Proposal

	<i>Congressional members</i>	<i>Consumer groups</i>	<i>Individuals</i>	<i>State and local agencies</i>	<i>State legislators</i>	<i>Realtors</i>
Concerns about the diminishing effect of the bank activities preemption proposal on the enforcement of state consumer protection laws and the amount of resources that the OCC has to devote to consumer complaints.	●	●	●	●	●	●
Concerns about OCC’s legal analysis and conclusions justifying preemption.	●	●		●	●	●
Concerns regarding state and local agencies’ ability to regulate operating subsidiaries (Realtors, consumer groups, state and local, state legislators).	●	●		●	●	●
Concerns that OCC’s bank activities preemption proposal will threaten the dual banking system.	●	●	●	●	●	●
Concerns that OCC could further attempt to exempt national banks from laws that would otherwise apply.		●	●	●	●	●
Concerns that OCC may be too focused on promoting the interests of its regulated entities to effectively regulate them.	●	●	●	●		
Concerns describing the detriment of limiting state involvement in the regulation of the banking industry, which may limit future legislation; states are more responsive, offer more timely legislative corrections, and are more creative in their lawmaking.		●	●	●	●	●
Preemption rules may have a negative impact on state-chartered banking, which is critical to the ability of state officials to promote economic development and respond to local economic needs.	●	●		●	●	●
Concerns that OCC’s “Working Paper on Predatory Lending” and other studies that have examined the effect of state predatory lending laws on consumer markets have not produced definitive results.	●	●	●			
Describes the concerns of the real estate industry regarding licensing issues.		●	●	●	●	●
Comments arguing that consumers continue to be victims of deceptive trade practices, including predatory lending.	●	●	●	●	●	●

Source: GAO.

Note: We based our analysis on 373 comment letters (nonform letters) submitted to OCC during the public comment period for the banking activities proposal.

Consumer groups and state officials commented that OCC’s rule would cripple states’ ability to regulate national banks and their operating subsidiaries, and in the process potentially increase the number of consumer complaints sent to OCC regarding national banks and their operating subsidiaries. They asserted that OCC did not have the capacity to adequately handle an increased volume of complaints, and argued that “with an already fully engaged staff of national bank examiners and OCC employees, the Comptroller cannot match the resources of state banking

departments, consumer credit divisions, and offices of state attorneys general that currently work to identify fraudulent and abusive practices.”

The issues cited next most frequently (by commenters opposed to the rule) dealt with the legal basis for preempting state regulation of national banks’ operating subsidiaries. The commenters questioned OCC’s legal authority to promulgate the rule, asserting that OCC did not properly apply the legal standard for preemption and did not have a legal basis for preempting state laws with respect to national bank operating subsidiaries. These commenters stated that preempting the application of state laws to operating subsidiaries would infringe on states’ rights to regulate entities that they license. They asserted that OCC’s preemption proposal would “federalize” national bank operating subsidiaries, many of which are state-licensed.⁴⁷ Additionally, commenters noted that if finalized, OCC’s preemption rule would prevent states from regulating these entities and would diminish the states’ ability to protect their citizens. State officials contended that federal banking statutes and state corporate laws establish a clear separation between national banks and their “affiliates,” including their operating subsidiaries. Accordingly, these commenters believed that OCC did not have the power to bar states from licensing, examining, and otherwise regulating state-licensed corporations, including those affiliated with national banks. This issue was of particular concern to commenters who believed that certain national bank operating subsidiaries engaged in predatory and abusive practices. Another commenter suggested that OCC’s rule would encourage lenders to “restructure as operating subsidiaries of national banks to avoid certain consumer protection restrictions.”

Commenters also expressed concerns about the effect of the rule on the dual banking system and contended that OCC’s rule would promote a “race to the bottom” in consumer protection. Consumer groups and state officials held that the banking activities rule could put national banks at an advantage over other financial institutions and blur the well-established competitive marketplaces of each state. They argued that the result would be a reduction in regulatory oversight in the banking industry because other bank regulators would be encouraged to reduce their regulatory efforts to match what some considered “subpar” standards being set for national banks. State officials believed that this result would be inevitable

⁴⁷National banks are not subject to state chartering requirements or laws governing the formation and conduct of business entities. National bank operating subsidiaries, however, typically are formed under the laws of a particular state.

because regulatory control of the banking industry would be concentrated in OCC.

State officials and consumer group commenters asserted that OCC took a sweeping approach to preemption in its proposal. They noted that a state law generally would apply to a national bank only if the state law fit into one of a few limited categories or if OCC decided that the particular state law has “only incidentally affected” the exercise of national bank powers or is otherwise consistent with the rule itself. Commenters contended that absent specific consent from OCC, the only types of state laws that would ordinarily apply to national banks are those enumerated in the proposal (such as those pertaining to contracts, torts, and criminal law). They stated that national banks could even be exempted from these types of laws if OCC decided that one of these types of state law marginally affected the exercise of national bank power. These commenters concluded that the national bank charter could become a “get out of jail free” card.

Generally, proponents of OCC’s preemption proposal, largely national banks and others representing the banking industry, stated that the rule promoted a uniform national regulatory standard, which they viewed as a significant benefit to national banks and argued that field preemption would allow national banks to provide services on a multistate basis without being subject to a patchwork of conflicting and inconsistent state laws. According to these groups, without a national standard, national banks operating under varied state laws faced increased costs, compliance burdens, and possible litigation because of not being able to comply with each and every requirement. Further, they contended that some national banks could be forced to limit certain products and services in jurisdictions where state and local laws imposed different standards, thus harming consumers. They suggested that these state laws would ultimately harm the national bank system and therefore urged OCC to adopt an “occupation of the field” preemption standard concerning national bank real estate lending.

National bank industry commenters also expressed concern that the proposed anti-predatory lending standard prevented national banks from making loans based predominantly on the foreclosure value of a borrower’s collateral—that is, without regard to the borrower’s repayment ability. These commenters contended that this new standard would prevent national banks from making legitimate loans, for example, to high net worth individuals whose ongoing cash flow could be sufficient to repay the

loan. These commenters noted that reverse mortgage, small business, and high net worth loans are often made based on the value of the collateral.

Supporting commenters also asked OCC to clarify particular parts of its proposal. For example, several commenters noted that section 34.4(a) of the banking activities preemption proposal lists “categories” of state laws that are preempted, but did not specifically enumerate which state laws would be preempted. A number of these commenters asked OCC to list in its final rule specific state laws imposing various limitations on mortgage underwriting and servicing and those state laws pertaining to debt collection, which were not determined to be preempted in the proposal.

In Response to Comments, OCC Reasserted Its Preemption Authority but Made Some Changes in the Final Rule

We analyzed a variety of sources and determined that while OCC considered all of the comments it received during the banking activities rulemaking, they strongly disagreed with commenters that doubted their ability to protect consumers as well as those that questioned their preemption authority. OCC stated in the preamble to the final rule that national banks and their operating subsidiaries would be regulated by strong federal standards and any abusive practices would not be tolerated. Moreover, OCC maintained that national banks were not the source of predatory and abusive lending practices. The Comptroller also suggested that the banking activities rule did not affect a state’s ability to protect vulnerable consumers from other types of lending institutions that might engage in predatory practices. The Comptroller emphatically suggested that the banking activities preemption standards “are comprehensive and apply nationwide, to all national banks. The rules apply strong protections for national bank customers in every state—including the majority of states that do not have their own anti-predatory lending standards.”

According to OCC officials, the agency has a comprehensive consumer protection effort focused on national banks and operating subsidiaries (consisting of its supervisory and enforcement functions, the Customer Assistance Group, and the Community and Consumer Law and Enforcement and Compliance divisions of the Law Department). According to OCC, this effort includes enforcement of applicable state laws and a comprehensive array of federal consumer protection laws. This consumer protection effort will be the focus of one of our forthcoming reports. OCC also maintained that states increasingly face budget constraints, and their insistence on adding national bank supervision to an ever-increasing list of responsibilities would likely detract from “the availability of state resources to protect consumers in *other* areas—other areas where there *is*

evidence of abusive lending—other areas that are not as highly regulated as the banking business.”

OCC restated its authority to promulgate its banking activities rule throughout the preamble to the final banking activities rule, maintaining that it is charged with the primary responsibility of making certain that national banks operate efficiently and to the full extent of their powers under federal law.⁴⁸ Moreover, OCC contended that its regulation codifies existing determinations and prior Supreme Court decisions regarding national bank operations and had no effect on regulations previously established to govern the activities of national bank operating subsidiaries. Pursuant to OCC regulation, national bank operating subsidiaries conduct their activities subject to the same terms and conditions that apply to the parent banks, except where federal law provides otherwise.⁴⁹

OCC noted in the preamble to the final banking activities rule that differences between state-chartered banks and federally chartered banks and the supervision of each were the “defining characteristics” of the dual banking system and that its final rule would preserve, not undermine, this system. The preamble concluded that OCC fundamentally disagreed with state and local officials on this issue and asserted that the rule was a necessary component to “enable national banks to operate to the full extent of their powers under federal law, and without interference from inconsistent state laws; consistent with the national character of the national banks; and in furtherance of their safe and sound operations.”⁵⁰ However, OCC acknowledged the concerns of both opponents and supporters of the proposal and made some changes based on their comments. For instance, OCC added an express reference to section 5 of the Federal Trade Commission Act, which makes unlawful “unfair or deceptive acts or practices,” in response to commenters who urged OCC to

⁴⁸This responsibility includes helping to ensure that national banks operate as authorized by Congress, in alignment with the essential character of a national banking system and without undue constraint of their powers. OCC also explained that federal law gives it broad rulemaking authority to fulfill its regulatory responsibilities and cited 12 U.S.C. 93a, which explains how OCC is authorized “to prescribe rules and regulations to carry out the responsibilities of the office,” and 12 U.S.C. 371, which authorizes OCC to “prescribe by regulation or order” the “restrictions and requirements” on national banks’ real estate lending power.

⁴⁹See 12 C.F.R. §§ 5.34 and 7.4006. See also 69 Fed. Reg. 1905, 1906.

⁵⁰69 Fed. Reg. 1915 (2004).

declare that this federal standard indeed applied to national banks. OCC viewed this as a fitting addition to its rule. OCC also stated that its anti-predatory lending standard augments prior standards such as those contained in OCC's Advisory Letters on predatory lending. According to the Comptroller, OCC pioneered the use of section 5 as a basis for enforcement actions against banks that have engaged in such conduct. In contrast, in response to commenters who suggested that OCC specifically articulate what activities constitute unfair and deceptive practices, OCC noted in the preamble to the final banking activities rule that it does not have authority to specify by regulation specific practices as unfair or deceptive under the Federal Trade Commission Act. In February 2005, OCC issued new guidance pursuant to the enforcement scheme of section 39 of the Federal Deposit Insurance Act, "as a further step to protect against national bank involvement in predatory, abusive, unfair, or deceptive residential mortgage lending practices."⁵¹ This guidance describes practices that OCC deems inconsistent with sound residential mortgage lending practices. It also describes other terms and practices that may be conducive to predatory, abusive, unfair, or deceptive lending practices, depending on the circumstances. OCC noted in the guidance that it has the discretion to take action to enforce the guidelines.

In response to comments arguing that the banking activities rule would at some point preempt categories of state law that the proposal declared would not be preempted, OCC stated that it "refined" some language in the final rule and further explained in the preamble the standards to be used in determining when preemption would occur and the criteria for when state laws would not be preempted. OCC further explained that (1) state statutes and standards that federal law makes applicable or incorporates and (2) state laws that relate to the daily course of business of national banks and their operating subsidiaries, but only incidentally affect the bank's exercise of its federally authorized powers or otherwise are consistent with federal law, would not be preempted.⁵² The latter category includes laws pertaining to contracts, rights to collect debts, the acquisition and transfer of property, taxation, zoning, crimes, and torts. Additionally, in response to comments that OCC solicited on whether it should "occupy the field" of real estate

⁵¹70 Fed. Reg. 6329 (2005).

⁵²69 Fed. Reg. 1911-12, 1913.

lending, OCC determined that it would not do so based on comments it received pertaining to this issue and prior judicial decisions.⁵³

With respect to its new anti-predatory lending standard, OCC agreed with comments that suggested that there are instances where loans are legitimately underwritten on the basis of the value of the borrower's collateral and revised the anti-predatory lending standard to clarify that it would apply only to consumer loans secured by real estate. OCC characterized consumer loans as loans for personal, family, or household purposes and stressed that this standard was intended to prevent borrowers from being unwittingly placed in a situation where repayment would be unlikely without the lender seizing the collateral and that it would permit national banks to use a variety of methods to determine a borrower's ability to repay.

OCC acknowledged supporting comments requesting that it specifically list additional categories of state law that these commenters believed should be preempted, but chose not to do so. Instead, OCC included language in the rule's preamble asserting that the list of the types of preempted state laws enumerated in the rule were not intended to be exhaustive, that it would retain the ability to address other types of state laws on a case-by-case basis, and make determinations on preemption under applicable standards. Further, in a clarification concerning debt collection activities, OCC officials explained that it was difficult to establish a standard that would capture all of the concerns raised regarding national bank debt collection activities. As a result, OCC changed the description of this type of non-preempted state law from laws concerning "debt collection" to laws affecting a national bank's "rights to collect debts" (making all phrasing consistent with that used in a Supreme Court decision). OCC officials told us that they ultimately decided to leave the

⁵³OCC states in the final version of its banking activities rule that upon further consideration (including careful review of comments submitted pertaining to this point) of whether it should "occupy the field" of real estate lending, it concluded, as the Supreme Court recognized in *Hines* and reaffirmed in *Barnett*, that the effect of labeling of this nature is largely immaterial in the present circumstances. As a result, OCC declined to adopt the suggestion of certain commenters that it declare that the regulations "occupy the field" of national banks' real estate lending, other lending, and deposit-taking activities and chose to rely on its authority under both 12 U.S.C. 93a and 371. To the extent that an issue arises concerning the application of a state law not specifically addressed in the final regulation, it would retain the ability to address those questions through interpretation of the regulation, through issuance of orders pursuant to its authority under 12 U.S.C. 371, or, if warranted by the significance of the issue, by rulemaking to amend the regulation.

interpretation of this term open to the possibilities of subsequent OCC action or interpretation by the courts.

Stakeholders Raised Issues Regarding the Process OCC Used to Promulgate Its Preemption Rules

Some Members of Congress, state officials, and consumer groups criticized how OCC promulgated the banking activities rules. For example, some members requested a delay in the finalization of the rules so that they could hold additional hearings to discuss the rules' potential impacts on consumer protection. According to OCC officials, they could not determine the length of the delay that some members were requesting, and a lengthy delay would have created more uncertainty for national banks regarding the applicability of state or local laws and could have led some lenders to leave certain markets. Moreover, according to OCC, while some members sought a delay, other members did not endorse a delay. Additionally, some representatives of consumer groups and state organizations criticized OCC for not employing additional mechanisms for soliciting public input in the rulemaking. Other regulators told us they have used additional mechanisms for public comment during rulemakings they deemed controversial.

Congressional Members Requested a Delay in the Finalization of the OCC Rules

Some Members of Congress requested that OCC delay finalization of its rules so that they could further study its potential impact. However, congressional members and staff did receive information on the rules prior to this request. According to a chronology provided to us by OCC staff, OCC officials briefed a number of congressional members and their staff starting in October 2002 and ending in October 2003. In several of these briefings, the then-Comptroller of the Currency and OCC's Chief Counsel briefed majority and minority staff from the Committee on Financial Services, House of Representatives, and the Senate Committee on Banking, Housing, and Urban Affairs.

Some Members of Congress wanted OCC to delay the finalization of the rules so that they could hold hearings on the proposed rules. According to a letter from members of the House Financial Services Committee from the state of New York to OCC, the focus of the hearings would be the potential impact of the rules on consumer protection and the dual banking system. The Acting Comptroller of the Currency described that OCC staff received mixed views from within Congress and that some members of the House Financial Services Committee wanted a hearing while others did not endorse a delay or hearing. Since the OCC staff did not receive any

information on a specific date for the hearing, they were uncertain about the length of the delay that the members were requesting.

In congressional testimony (in late January 2004), the Acting Comptroller provided reasons for why the agency finalized the rules when it did.⁵⁴ First, the rules were not creating any “new law” because the rules were entirely consistent with existing laws, such as the National Bank Act. Second, the continuing uncertainty about the applicability of state laws had affected national banks’ ability to lend in certain markets and access the secondary market. Third, the Acting Comptroller asserted that state and local governments were accelerating enactment of anti-predatory lending legislation.

The Acting Comptroller provided us with a similar explanation, saying that OCC was receiving inquiries at the time from national banks requesting a clarification on whether state laws on anti-predatory lending would be applicable to them and advising OCC that these state laws were creating market impacts. A lengthy delay would have resulted in more uncertainty for the banks because more states would have continued enacting anti-predatory lending laws, which would have adversely affected the U.S. mortgage market. Moreover, she noted that a number of state anti-predatory lending laws were to come into effect during 2004, and OCC anticipated that additional states were planning to enact such laws. OCC officials also noted that the former Comptroller of the Currency became ill during the final stages of the banking activities and visitorial powers rulemaking. Because OCC did not have a date for the potential congressional hearing and the Comptroller wanted to take part in the finalization of the rules, OCC staff worked to be in a position to complete the rulemaking process by late January 2004.

Some Groups Criticized OCC’s Efforts to Solicit Public Input

Consumer and state groups wanted OCC to provide additional mechanisms beyond written comments for soliciting public input. Some consumer groups told us that OCC should have held “public meeting type” hearings and extended the length of the 60-day comment period to obtain public

⁵⁴See testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, Subcommittee on Oversight and Investigations of the Committee on Financial Services, U.S. House of Representatives, January 28, 2004. Also see testimony of John Hawke Jr., Comptroller of the Currency, Office of the Comptroller of the Currency, Committee on Banking, Housing and Urban Affairs, U.S. Senate, April 7, 2004.

comments on the banking activities rule. In their view, the banking activities rule was a controversial proposal that required OCC to obtain sufficient input from groups across the country. According to these groups, it has been a standard practice at other federal agencies to hold these types of meetings when the agencies deem that proposed rules would be controversial. Some consumer groups considered that public meetings were an important part of an educational, democratic process.

According to OCC officials, it was not OCC's standard procedure to hold "public meeting type" hearings on proposed rulemakings. The Acting Comptroller of the Currency told us that she personally conducts outreach to consumer groups and the banking industry on a variety of issues, including preemption; also, she did not foresee that she would have heard anything different in a public hearing than in her outreach sessions. OCC also has staff in the Community Affairs Department and a Banking Relations Senior Advisor, who, according to OCC staff, host outreach efforts with consumer and banking groups, respectively, on a frequent basis. These efforts provide these groups with an opportunity to comment on issues.

Some Federal Regulators Have Used Additional Mechanisms for Obtaining Public Comments on Controversial Rulemakings

Based on our interviews with FDIC, Federal Reserve, OTS, and SEC, staff employ additional mechanisms for soliciting public input for rulemakings. According to its Deputy General Counsel, FDIC will take steps in addition to accepting written comments to alleviate some of the controversy associated with certain rulemakings. For example, from the mid-1980s to 2005, FDIC held approximately seven "public meeting type" hearings on its rulemakings. The most recent concerned a request from a bank industry group that FDIC issue rules that would allow a state bank's home state laws to govern the interstate activities of state banks and their subsidiaries to the same extent that the National Bank Act governs a national bank's interstate activities. In announcing the public hearing on March 21, 2005, FDIC stated that if it agreed to conduct a rulemaking on preemption, the rulemaking proposal would be published in the *Federal Register* and an opportunity for public comment would be provided. On May 24, 2005, FDIC held the hearing on the preemption request; participants were an attorney representing the Financial Services Roundtable, the CSBS Chairman, five state banking regulators, an organization representing community bankers, the National Association of Realtors, and representatives from the three community groups and four banks. After each panel presented its views, FDIC staff asked questions of the panelists regarding the merits of the request and discussed issues with them. Additional parties chose not to

appear at the hearing, but submitted written views on the petition. On July 19, 2005, in a meeting open to the public, the FDIC Board voted to table the preemption request from the bank industry trade group but directed its staff to develop a more thorough notice of proposed rulemaking on the issue.

OTS has rarely held “public meeting type” hearings on proposed rulemaking proceedings, but according to OTS officials, OTS has held what the officials called “town meetings” on a regular basis at its field offices and has used them as an opportunity to identify emerging issues. Similar to OCC, OTS will forward advance copies of rulemaking proposals that may have federalism implications under E.O. 13132 to CSBS officials about 1 week before the proposal is published in the *Federal Register*. But, on occasion, OTS will contact other organizations representing state officials and regulators, including the National Association of Attorneys General and the American Association of Residential Mortgage Regulators, for input on OTS’s rulemaking proposals. OTS officials told us that they may meet occasionally with groups during the public comment stage of a rulemaking, but if they did, then staff would include a transcript of the discussion in the rulemaking file.

Federal Reserve policy provides that the usual method for the public to provide input on a rulemaking is through written comments. According to Federal Reserve staff, the Federal Reserve has not held a formal “public meeting type” hearing for a rulemaking in the last 5 years. However, according to Federal Reserve staff, the agency often conducts a substantial amount of outreach activity with interested parties before the rulemaking process starts or a proposal is published in the *Federal Register*. Even after a rulemaking has commenced, Federal Reserve officials or staff may hold meetings with interested parties. According to Federal Reserve staff, written summaries of these meetings typically are prepared and placed on the Federal Reserve Web site and in the public comment file for the particular rulemaking. Although OCC officials told us that they held outreach meetings, they did not document the meetings and submit summaries to the public comment file or document outreach meetings with consumer groups. In addition, the Federal Reserve has considered ideas for consumer regulations from participants who have made presentations to the Consumer Advisory Council and have brought the topics of possible or

ongoing rulemakings before the Consumer Advisory Council to obtain the views of council members.⁵⁵

SEC has held special public meetings, such as roundtables, to solicit additional input from outside parties. According to SEC staff, the agency uses the meetings to allow commenters to elaborate on their comments and discuss their comments with others. SEC staff told us that special public meetings have been held for rule proposals that raise particular public interest or are technically complex.

Finally, in contrast to OCC, all of the regulators place the comments they receive on their proposed rulemaking on their Web sites. Posting the comments on the Internet allows organizations and individuals who are planning to submit comments to read the comments already received by the agencies. The objective of the governmentwide E-Gov rulemaking initiative pilot is to require federal agencies to place public comments on a centralized Web site to make them easily accessible to the public, and OCC concluded that it would be inefficient to devote resources to establish a public comment posting system that would quickly be rendered obsolete by the E-Gov centralized system.

Observations

The preemption of state law relating to the business of banking has long been a controversial issue. It seems to have become more so with consolidation in the financial services industry, which has resulted in large national banks' presence in virtually every state in the country. As the regulator of national banks—including some of the nation's largest—OCC's decisions can be far reaching. OCC can help mitigate some of the controversy that inevitably will ensue from its preemption decisions by ensuring that its proposals are thoroughly aired with all relevant stakeholders.

In OCC's recent preemption rulemakings, controversy focused both on the agency's legal analysis justifying preemption and on the possible effects of its rules on state-chartered banks and consumers. Federal law and

⁵⁵The Federal Reserve's Consumer Advisory Council comprises academics, state and local government officials, representatives of the financial industry, and representatives of consumer and community interests. It was established pursuant to the 1976 amendment to the Equal Credit Opportunity Act to advise the Federal Reserve on consumer financial services.

executive orders requiring agency accountability and stakeholder involvement drove public input on these matters. Following requirements in the APA and 12 U.S.C. § 43, OCC provided public notice of the proposed rules and sought public comment. The agency extended the opportunity for public comment to 60 days rather than the more typical 30 days, and it considered all of the comments and made changes it deemed appropriate. With respect to agency rulemakings that preempt state law, the “Federalism” executive order calls for an “accountable process to ensure meaningful and timely input by state and local officials” and, because of the possibility of a conflict between state law and federal interests, requires agencies to “consult, to the extent practicable and permitted by law, with appropriate state and local officials in an effort to avoid such a conflict.” Beyond the consideration of comments required by statute, OCC arranged for formal meetings with CSBS and followed the consultative process set forth in the letters exchanged by OCC and CSBS in 1999. In the face of an executive order specifically calling for state and local consultation on preemption rules, OCC’s limited additional effort may have contributed to an impression that it did not genuinely seek or consider input from this community. Stakeholders representing such diverse interests as consumer protection advocates, state bank regulators, state attorneys general, and some Members of Congress continue to maintain that the agency did not genuinely seek their input.

Executive Order 13132, entitled “Federalism,” affords agencies flexibility in determining precisely how much input is appropriate in any given circumstance, and we do not assert that OCC did not follow these requirements. As a practical matter, however, the agency’s own interests in developing workable regulations and in reaching acceptable resolutions might have been better served in this case by providing more opportunity for discussion by those most directly affected. We note that even where preemption was not an issue, other federal financial institution regulators took additional actions, such as holding public meetings, to ensure wider involvement in the public review and comment on proposed regulations they deemed controversial.

Finally, OCC’s rulemaking process would benefit from better documentation—both written guidance for the process itself and more thorough documentation that the process is followed in specific rulemakings. Other financial institution regulators use written procedures that provide a framework for ensuring their compliance with applicable requirements. Such procedures can help agency officials ensure that appropriate criteria for rulemaking—whether in the APA, other laws, or

executive orders—are followed and documented. We were able to determine the process OCC followed for the preemption rulemakings only by pulling together information from multiple sources, including the rulemaking dockets, other OCC documents, and officials and stakeholders we interviewed. OCC’s rulemaking files alone did not contain much of this information—the files omitted details on both the fact and substance of OCC communications with key stakeholders. Given the controversial circumstances surrounding these rulemakings, it might have been in the agency’s best interest to have created better documentation of its actions and decisions. Moreover, federal internal control standards stress the importance of such documentation for verifying that management directives and guidance have been carried out and that the agency has complied with applicable laws and regulations. Without documentation about matters such as how decisions were reached, who was consulted, and what their views were, we were not able to present information in this report that might have contributed to a better understanding of OCC’s process.

Agency Comments and Our Evaluation

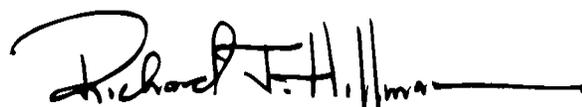
We provided a draft of this report to OCC for review and comment. In written comments, the Comptroller of the Currency (see app. II) concurred with our observation that its rulemaking process could benefit from more detailed written rulemaking procedures. OCC has begun a project to develop such procedures and expects to complete them by the end of 2005. OCC expressed concerns about the draft report’s observation that staff memorandums in OCC’s rulemaking files did not articulate the analysis underlying OCC’s conclusion that the rules were not “significant” for purposes of E.O. 12866. OCC commented that the files contained seven memorandums prepared by OCC’s legal and economic policy staff describing their analysis and conclusions under E.O. 12866. OCC believes the agency satisfied the requirements of the executive order. During our review, we examined the staff memorandums for both the visitorial powers and the banking activities rules. However, the analyses in the memorandums consisted of stating that the rule was not a “significant regulatory action,” as defined by E.O. 12866 because the annual effect on the economy was less than \$100 million and did not address the other criteria set forth in the order for determining whether an action is

significant.⁵⁶ The memorandums did not include or refer to any analysis to support the conclusion stated. Thus, we continue to maintain that OCC's documentation did not articulate the analysis underlying its conclusion that the rules were not "significant" for purposes of E.O. 12866.

Finally, although OCC disagreed with the draft report's observation that the extent of OCC's consultation with state officials appeared limited, it intends to make improvements in this area. In OCC's view, its consultation with state officials complied with the "Federalism" executive order and was appropriate in view of the nature of the preemption rulemakings. However, OCC stated that it is committed to enhancing its efforts in "continuous, open and candid dialogue" with state and federal regulators on issues such as assuring consumer protection. The Comptroller stated that he had already had several meetings to further this goal. OCC also provided technical comments that we incorporated, as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will provide copies of this report to the Comptroller of the Currency and interested congressional committees. We also will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-8678 or hillmanr@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors are acknowledged in appendix III.



Richard J. Hillman
Managing Director, Financial Markets and
Community Investment

⁵⁶In addition to the \$100 million measure, the order sets forth other criteria for determining whether a rule is significant. These include whether a rule would have an adverse affect in a material way on state, local, and tribal governments or communities.

Objectives, Scope, and Methodology

The Office of the Comptroller of the Currency (OCC) recently issued two final rules to clarify the applicability of state law to certain national bank operations, commonly known as the bank activities or “preemption” rule and OCC’s authority to examine, supervise, and regulate activities authorized for federally chartered or national banks under federal law, known as the “visitorial powers” rule. The proposed rules and OCC’s rulemaking process drew strong reactions of either support or opposition from the banking industry, state officials, consumer group representatives, and some Members of Congress. In our report, we (1) assess OCC’s rulemaking process within the framework of applicable laws and executive orders, (2) determine the issues raised in the comment letters on the substance of the preemption rule and describe if and how the OCC responded to these issues, and (3) identify issues stakeholders raised about the process OCC used to promulgate both the banking activities and the visitorial powers rules and determine OCC’s response.

To assess OCC’s rulemaking process within the framework of applicable laws and executive orders, we focused on the process OCC used to promulgate its rules on banking activities and visitorial powers. We reviewed the laws and executive orders relevant to the two rules: section 553 of the Administrative Procedure Act, the Regulatory Flexibility Act, the Congressional Review Act, Executive Order 12866 on Regulatory Review, and Executive Order 13132, “Federalism.” To determine OCC actions in conducting its rulemaking, we interviewed officials from OCC’s Legislative and Regulatory Activities Division who were responsible for the initial drafting of the banking activities and visitorial powers proposals and final rules. In addition, we reviewed OCC’s internal files for both rulemakings, including materials from the dockets.¹ The documents we reviewed included correspondence between OCC officials discussing the status of the rules, staff memorandums sent to the Chief Counsel and the Comptroller of the Currency, OCC’s written communications to staff from the Office of Management and Budget (OMB) and the Department of Treasury (Treasury), and a list of the public commenters for both rulemakings. Using information from OCC files and the proposed rule in the *Federal Register*, we compared OCC’s actions related to the rulemakings with the provisions we identified in relevant laws and executive orders. We interviewed officials from OMB’s Office of

¹Public comments as well as other supporting materials (e.g., hearing records or agency regulatory studies but generally not internal memorandums) are placed in a rulemaking “docket,” which must be available for public inspection.

Information and Regulatory Affairs and Treasury’s Office of General Counsel. In addition, we interviewed staff from other federal financial regulatory organizations (the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the Securities and Exchange Commission) to obtain information on their rulemaking processes.

To identify the issues raised in comment letters concerning the banking activities rule, we conducted a content analysis of 373 comment letters received by OCC on its bank activities preemption proposal.² While OCC received 2,706 comment letters, we identified 2,250 as form letters, most of which expressed identical concerns about financial subsidiaries of national banks possibly conducting real estate brokerage activities without complying with state real estate brokerage licensing laws.³ However, financial subsidiaries currently are not allowed to conduct real estate brokerage activities, and OCC concluded that these letters were not relevant to its review of the public comments because the bank activities preemption proposal did not apply to financial subsidiaries of national banks.⁴ Therefore, we decided it was not appropriate to include these form letters in our content analysis for identifying issues related to the banking activities rulemaking. Additionally, we identified 83 duplicate letters (more specifically, copies of letters received in more than one medium, such as fax, mail and e-mail), which we also excluded from our content analysis.

To analyze the comments, we first separating the letters into three categories: letters that supported the banking activities ruling (37), letters that opposed the ruling (316), and letters that neither supported nor opposed the ruling (20)—that is, the commenters requested clarification of certain parts of the proposal. We then randomly selected and reviewed a “developmental” set of letters from each category and established an initial set of codes that would further characterize comments within each category. We applied these codes to a test set of letters and made refinements. We then applied the refined codes to a second test set of

²Our analysis focused on comments submitted in response to OCC’s bank activities proposal.

³Most of the public comments were from Realtors.

⁴The Board of Governors of the Federal Reserve System and the Department of the Treasury are considering a proposal to permit financial subsidiaries to do this activity, but have not finalized any proposal as of the date of this report.

letters, made more adjustments, and established the final codes for each category of letter. We distributed letters from each category among three pairs of trained coders, who independently coded their set of letters and resolved discrepancies to 100 percent agreement. The coders regularly performed reliability checks throughout the coding process. To further ensure consistency across coding pairs, one reporting team member met regularly with each coding pair while they performed their reliability checks to help resolve any conflicts across the pairs. The coders recorded their results on a standardized data collection instrument, and one coder from each pair entered the results into an electronic data file, and 100 percent of the entered data was verified for accuracy. Descriptive statistics for the codes were computed using SAS statistical software. A second independent analyst reviewed the data analysis.

To determine the extent to which OCC considered and addressed the comments, we identified any changes between OCC's proposed and final version of the rule. We analyzed the preamble to the final rule in which OCC acknowledged the public comments it received and discussed its responses. We then identified the rule changes that OCC attributed to public comments and the public comments OCC acknowledged it did not address. We verified our analysis with OCC officials from the Division of Legislative and Regulatory Activities. In addition, we reviewed OCC's internal memorandums on the banking activities rule to identify OCC's views on the issues arising from the public comments and its assessment of the comments.

To identify issues stakeholders raised about the process OCC used to promulgate the banking activities rule and the visitorial powers rule, we identified and interviewed interested parties that may be impacted by the banking activities and visitorial powers rules. We interviewed representatives of organizations of state officials (Conference of State Bank Supervisors, National Association of Attorneys General, National Governors Association, and National Conference of State Legislatures). In addition, we interviewed officials from consumer organizations (Center for Responsible Lending, Consumer Federation of America, National Community Reinvestment Coalition, and National Consumer Law Center). We also analyzed correspondence from congressional members to OCC that questioned OCC's rulemaking process and congressional hearing transcripts and testimonies. To obtain information on OCC's response to the criticisms regarding its rulemaking process, we interviewed the Acting Comptroller of the Currency and officials from OCC's Division of Legislative and Regulatory Activities. Finally, we interviewed staff from the

Appendix I
Objectives, Scope, and Methodology

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and Securities and Exchange Commission on additional mechanisms that they used to solicit public comments in connection with informal rulemakings they considered controversial.

Comments from the Office of the Comptroller of the Currency



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 23, 2005

Mr. Richard J. Hillman
Managing Director, Financial Markets and Community Investment
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Hillman:

Thank you for the opportunity to review the draft report prepared by the United States Government Accountability Office (GAO) concerning the OCC's rulemaking processes with respect to the preemption and visitorial powers rules that we issued in January, 2004.¹ We are gratified by the GAO's finding that the OCC "followed the statutory framework for rulemaking" in issuing these rules. The integrity of our rulemaking process is critically important to the public, to the banks we supervise, and to us. Your conclusion that the OCC followed the law confirms our view that our process for issuing the rulemakings that you reviewed was both open and thorough, in conformity with the applicable legal requirements.

Although the OCC has issued internal guidance describing the procedures we use for developing positions and reaching decisions on matters addressed through a rulemaking,² the draft report observes that our process would benefit from more detailed written rulemaking procedures. We concur. Accordingly, we have initiated a project to augment our current Policies and Procedures Manual with more detailed written rulemaking procedures. I have directed that this work be completed by year-end 2005.

We have concerns, however, regarding observations in the draft report about certain aspects of the OCC's documentation of its compliance with executive orders that pertain to rulemaking by executive agencies. Briefly, our concerns are the following:

¹ 69 Fed. Reg. 1904 (January 13, 2004) (the preemption rule) (rule clarifying the applicability of certain types of state law to national bank operations) (*codified at* 12 C.F.R. §§ 7.4007, 7.4008, 7.4009, 34.3, and 34.4); 69 Fed. Reg. 1895 (January 13, 2004) (the visitorial powers rule) (clarifying the scope of the exclusivity of the OCC's visitorial powers) (*codified at* 12 C.F.R. § 7.4000).

² See OCC Policy and Procedures Manual, PPM No. 1000-10 (Rev), *Internal OCC Review Processes for Policymaking, Rulemaking and Other Significant Documents* (April 26, 2005). The OCC also uses a checklist to ensure that key steps in the rulemaking process are completed. We have provided these documents previously. While we agree, as described in the text, that our procedures should be improved, the PPM and checklist do comprise written rulemaking procedures.

Appendix II
Comments from the Office of the Comptroller
of the Currency

Documentation of OCC Analysis under Executive Order 12866. The draft report indicates that staff memoranda in the OCC's rulemaking files do not articulate the analysis underlying the OCC's conclusion that the rules were not "significant" for purposes of Executive Order 12866. The rulemaking files for the visitorial and preemption rulemakings reviewed by GAO staff contain seven memoranda, prepared by OCC legal and economic policy staff, describing our analyses and conclusions under Executive Order 12866, as well as the Regulatory Flexibility Act (RFA) and the Unfunded Mandates Reform Act (UMRA). These seven memoranda document our analyses and compliance with the applicable rulemaking requirements, and, we believe, satisfy those requirements.

Compliance with Executive Order 13132 (Federalism). The draft report acknowledges that the OCC has discretion and flexibility in determining how to comply with executive orders pertaining to rulemaking, including the Federalism executive order. It nevertheless contains the observation that the extent of the OCC's consultation with state officials appeared limited. We believe the consultation with state officials carried out by the OCC in connection with the preemption and visitorial powers rules complied with the Federalism executive order and also was appropriate in view of the nature of the rulemakings. However, we also agree that communication among state and Federal regulators on issues such as these, with jurisdictional implications, where both sides are committed to assuring consumer protection is not compromised, benefit from continuous, open and candid dialogue among the regulators. We are committed to enhancing our efforts in this area, and I already have had several meetings to further that goal.

With respect to the rulemaking process itself, we received extensive, thoughtful comments from a number of state officials and organizations, including the Conference of State Bank Supervisors (CSBS), the National Governors Association, the National Association of Attorneys General, and the National Conference of State Legislators. As noted in the draft report, our consideration of, and response to, those comments was described in detail in the preambles to the final regulations. In this regard, the OCC followed the consultation process to which the OCC and CSBS had agreed in 1999, a process that, in essence, ensured that the CSBS could alert state officials to rulemakings that might raise issues under the Federalism executive order so that those officials could prepare any comments accordingly.³

Consultation that relied principally on written input was a form of consultation particularly appropriate to the nature of these rulemakings, which presented issues predominantly legal in nature. Nevertheless, the OCC and the CSBS met twice during the rulemaking process. And, as indicated in correspondence between then-Comptroller Hawke and Thomas J. Miller, the Attorney General for the State of Iowa, the OCC met with a number of attorneys general during the time frame when the rules were under consideration.⁴ In sum, we believe our reliance on the

³ As the report notes, after the issuance of Executive Order 13132, the OCC and the CSBS agreed that: (1) CSBS would serve as the primary channel for communicating with state banking officials when OCC proposed a regulation that had Federalism implications; and (2) the OCC would send CSBS the draft of such a regulation shortly before the document was sent to the *Federal Register* for publication.

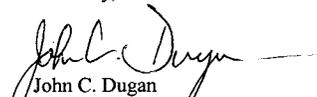
⁴ See Letter from Thomas J. Miller to John D. Hawke, Jr. (October 7, 2003). We have provided this document previously.

Appendix II
Comments from the Office of the Comptroller
of the Currency

Administrative Procedure Act comment process, supplemented by the informal discussions in which we participated, was appropriate to the circumstances of these rulemakings,⁵ and the preambles to the final preemption and visitorial powers rules, which are contained in our rulemaking files, included Federalism summary impact statements (as prescribed by the Federalism executive order) as well as detailed, substantive discussion of the Federalism points raised by commenters.

I appreciate this opportunity to provide the OCC's comments on the draft report, and I extend my thanks for the professionalism with which you and your staff have conducted this review.

Sincerely,


John C. Dugan
Comptroller of the Currency

⁵ Legal issues substantially similar to those raised in the preemption and visitorial powers rulemakings had been raised and extensively commented upon by the states and the public in various preemption matters in the months and years prior to the issuance of the final rules. For example, the OCC received comments from state officials and organizations prior to issuing our order and determination regarding the applicability to national banks and their operating subsidiaries of the Georgia Fair Lending Act. *See* 68 Fed. Reg. 46264 (August 5, 2003).

GAO Contact and Staff Acknowledgments

GAO Contact

Richard J. Hillman, (202) 512-8678

Staff Acknowledgments

In addition to the individual named above, Katie Harris (Assistant Director), Julianne Stephens Dieterich, Nancy Eibeck, Jamila Jones, Landis Lindsey, Alison Martin, Kristeen McLain, Marc Molino, Barbara Roesmann, Paul Thompson, and Mijo Vodopic made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548