"DUEL" BANKING SYSTEM? STATE BANK PARITY LAWS: AN EXAMINATION OF REGULATORY PRACTICE, CONSTITUTIONAL ISSUES, AND PHILOSOPHICAL QUESTIONS

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INTRODUCTION

Depository financial institutions in the United States, including banks, credit unions, and thrifts, are unique in that their incorporators and/or management have a choice between state and federal charters, regulatory authorities, and governing statutes. No other industry has separate and distinct laws governing its powers, regulation, and organizational structure. This phenomenon is known as the "dual banking system."[1] Every state has an agency, or agencies, that charter and regulate these three types of financial services providers.[2] Alternatively, federal charters for banks, thrifts, and credit unions are provided by the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), and the National Credit Union Administration ("NCUA"), respectively.[3] For reasons that will be discussed below, the availability of this choice of charters has contributed greatly to the industry innovations and the expansion of powers that financial institutions have experienced in this country. It has also provided necessary "checks and balances," ensuring against oppressive regulation. Further, the system fosters a competitive environment between state and federal regulators. This healthy competition and the "level playing field"[4] it fosters are essential to the survival of the dual banking system.

State bank parity laws have been one means by which states have striven to provide a charter choice that meets the needs of its regulated banks, is

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1. *See generally* Arthur E. Wilmarth, Jr., The Dual Banking System—A Legal History (Sept. 30, 1991) (unpublished paper presented at the Education Foundation of State Bank Supervisors (EFSBS) Seminar for State Banking Department Attorneys, on file with author).

2. Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 357 (1995); Raquel Maria Prieguez, *Federal Common Law and the Need for Uniformity in the Regulation of Federal Savings and Loan Associations and Federal Credit Unions*, 29 SAN DIEGO L. REV. 743, 751, 755 (1992).

3. Jerry W. Markham, *Banking Regulation: Its History and Future*, 4 N.C. BANKING INST. 221, 228 (2000); Prieguez, *supra* note 2, at 749, 786-88.

4. Kenneth F. Ehrlich, *Gramm-Leach-Bliley: Federal Preemption of Massachusetts Bank Insurance Sales Rules?*, 20 ANN. REV. BANKING L. 121, 125 (2001) (describing the intention of 1997 federal legislation to foster competition and equality between national and state charters). *Id*.

competitive with the federal alternative, and promotes "safety and soundness"[5] in the industry. Parity laws provide state regulators and lawmakers a flexible and timely method of expanding and/or amending the permissible powers of state-chartered banks in response to newly adopted federal initiatives.[6] This adaptability is particularly important given the fact that the legislatures in many states are in session only part-time.[7] The ability for states to adapt has become increasingly important in recent years, as federal regulators have aggressively interpreted their authority to expand the powers of federally chartered financial institutions.[8] While many of the issues to be addressed in this Note apply equally to all three types of traditional depository institutions—banks, thrifts, and credit unions—in order to keep the topic manageable, I will concentrate specifically on the bank charter.

Part I of this Note provides a brief history of the "dual banking system" in the United States. Included will be a discussion of the positive effects this system has had on the country's banking industry. Part II consists of an analysis of existing state bank parity laws and the various means of their application throughout the fifty states.[9] Included in this section is a discussion of the extent to which the parity laws preempt or simply supplement other state laws, and whether the powers are afforded automatically, or are subject either to the

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5. *See* Ralph E. Sharpe, *Prompt Regulatory Action and Safety and Soundness Tripwires Under FDICIA*, 625 PRACTICING LAW INST.—COMMERCIAL LAW 217, 236-44 (1992). "Safety and soundness" is the general standard under which bank regulators review the operations of banking companies. This article describes the standards and criteria used in determining banks' conformity to safe and sound practice.

6. *See* Letter from James B. Kauffman, Jr., Acting Secretary of Banking, State of Pennsylvania, to all Pennsylvania State-Chartered Banks, Banks and Trust Companies, Savings Banks, and Trust Companies (Nov. 29, 2000) (announcing the adoption of their parity provision, opining that it would ensure "a level playing field on which Pennsylvania State-Charters can continue to successfully compete") (on file with author); *see also* Press Release, New York Governor George E. Pataki (July 23, 1998) (recognizing a growing "competitive imbalance" and hailing New York's parity law as ensuring "the State banking charter will remain attractive and competitive") (on file with author).

7. John Devlin, *Toward a State Constitutional Analysis of Allocation of Powers: Legislators and Legislative Appointees Performing Administrative Functions*, 66 TEMP. L. REV. 1205, 1229 (1993). Though the frequency and length of state legislative sessions vary, their part-time nature can leave significant lapses of time between enactments of federal law and consideration by state lawmakers.

8. *See* Arthur E. Wilmarth, Jr., Recent Developments Related to the Preemption of State Laws by the Office of the Comptroller of the Currency ("OCC") and the Office of Thrift Supervision ("OTS") (July 31, 2001) (unpublished paper presented at the Conference of State Bank Supervisors ("CSBS") Legal Seminar) (on file with author).

9. Information compiled from a survey of state banking department representatives, telephone interviews, e-mail correspondence, and independent research, represented in Table I—Summary of State Bank Parity Laws, included *infra* [hereinafter Survey Results] (on file with author).

discretion of the state regulator, or to specific legislative constraints. Following is a discussion of the various types of powers and authorities that have been requested under parity provisions. Included in Part II is an analysis of the interplay between the parity provisions and the "incidental and proper" clauses that are also common in state banking codes. These "incidental and proper" clauses, which sometimes require regulatory approval, provide banks the ability to exercise powers that are not enumerated but are deemed "incidental and proper" to banking. When regulatory agencies interpret these "incidental and proper" clauses broadly, they can serve to expand permissible bank powers even in the absence of parity provisions.[10] Although parity provisions are designed to promote a "level playing field," particularly between state and national charters, "incidental and proper" clauses can be used to seek powers that, while arguably incidental to the business of banking, are not, as yet, available to national banks.

Part III of this Note discusses parity laws from a constitutional perspective. This question first arises in the form of a potential abdication or delegation of lawmaking authority by state legislatures when they provide for the "automatic" extension of theretofore-unauthorized powers to state banks at the discretion of federal lawmakers, or arguably worse yet, federal regulators.[11] This concern is heightened even further when the power that is extended to state banks was not previously simply unauthorized, but specifically prohibited by state law. A second question of delegation involves the constitutionality of a statute that allows a state executive branch agency the latitude to unilaterally expand a theretofore legislatively enacted list of permissible bank powers.

These issues lead to a discussion of philosophical issues in Part IV. Banks, while not public entities, certainly raise significant public policy concerns and benefit from public support, i.e., federal deposit insurance. They are in the business of accepting citizens' money in the form of deposits and investing it in, for example, loans, securities, and real estate. For these reasons, states have always had a strong interest in the powers and activities afforded to banks. Banks historically could only engage in specifically enumerated powers.[12] For better or worse, parity provisions can significantly alter this regulatory structure by expanding these powers beyond those adopted legislatively. In the case of parity provisions that automatically allow a state bank to engage in an activity

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10. The wording of these "incidental and proper" clauses varies from state to state. Examples include, "[d]o any business and exercise any powers incident to the business of banks," ALA. CODE § 5-5A-18(12) (1990 & Supp. 2001); "exercise all powers incidental and proper . . . in carrying on a general banking business," IND. CODE § 28-1-11-3.1(a) (1998 & Supp. 2001); "all powers incidental to the conduct of banking business," PA. STAT. ANN. tit. 7, § 315(I) (1995 & Supp. 2001).

11. As noted *supra*, note 3, the OCC is the chartering and regulatory authority for national banks. In that role, it is charged with interpreting the National Banking Act, and thus determining permissible powers for national banks. 12 U.S.C. § 24 (2000).

12. *See* Karol K. Sparks, *Banking and Insurance: One Year After Gramm-Leach-Bliley*, SF57 A.L.I.-A.B.A. 667, 671 (2001) (discussing the effect this new law will have on available bank powers).

that was previously unauthorized, or even specifically prohibited, the question becomes, "Why is it a safe business practice now?" This inquiry brings the whole historical practice of specifically enumerating bank powers into question.

A second philosophical issue is the importance of consistency, or lack thereof, among the various states in the adoption and application of parity provisions. In this age of interstate banking, seamless regulation is viewed favorably by large banking organizations. However, any lockstep effort by states could also be viewed as an endorsement of a national regulatory environment and an undermining of the dual banking system.

Parity provisions have played an important role in both the evolution of bank powers and the continued viability of the dual banking system. Their near-unanimous adoption throughout the country is evidence of their importance. Given the consistent state interest in protecting the safety and soundness of financial institutions, particularly in an interstate environment, an effective argument can be made for a more universal application of parity laws across state lines. Further, while the constitutionality of parity provisions can be debated, there have been no significant challenges to them. This is not likely to change given their utility and widespread acceptance.

I. Dual Banking System History

A. Structure of Bank Regulation in the United States

A dual banking system has existed in this country since the enactment of the National Banking Act in 1863.[13] Prior to this time, other than the First and Second Banks of the United States, only state banks existed. This structure had spawned several hundred state banks, each issuing their own currency. National banks were authorized in 1863 primarily due to the need to establish a uniform currency to fund the Civil War.[14] The OCC serves as the primary regulator and chartering authority for national banks, and the executive branch of each state maintains an agency charged with chartering and regulating state banks.

In addition, all national banks and virtually all state banks are insured by the Federal Deposit Insurance Corporation ("FDIC"), resulting in an additional regulator for most state banks, and in some instances, for national banks.[15] Further, all national banks and many state banks are members of the Federal

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13. Markham, *supra* note 3, at 228 (referencing the National Banking Act at 12 U.S.C. § 24 (2000)).

14. Thomas Mayer et al., Money, Banking, and the Economy 35-42 (1981).

15. *See* Johnson, *supra* note 2, at 358-61; *see also* Press Release, FDIC Chairman Donald Powell, Statement on FDIC Board Approval of Special Examination Activities (Jan. 29, 2002) (introducing an interagency regulatory agreement entitled "Coordination of Expanded Supervisory Information Sharing and Special Examinations") (on file with author). The agreement was negotiated between the FDIC, the OCC, the Federal Reserve Board, and the OTS, and it expands the circumstances under which the FDIC will conduct examinations of banks not directly supervised by the FDIC.

Reserve System that can result in additional regulation.[16] Also, all banking companies that have adopted a bank holding company structure are subject to regulation by the Federal Reserve Board ("FRB").[17] While the regulatory presence of the FDIC and FRB are not considered a part of the dual banking phenomena, the existence of this multitude of regulators, together with their respective regulations, can complicate the regulatory process for both bankers and regulators.

B. Effects of the Dual Banking System

The dual banking system provides a charter choice for bank management to exercise based on available powers, geographic concerns, accessibility of regulators, regulatory philosophy, and costs. Generally speaking, the larger interstate or international companies have tended to hold national charters. Smaller, community bankers often choose to operate under the more local regulatory environment provided by the state regulator. While these characterizations are only generalities, the numbers tend to support them. As of December 31, 2001, there were 8080 commercial banks in the United States.[18] Of these, 2137 were national banks and 5943 were state banks.[19] The average size of the national banks was $1.7 billion, while the average-sized state bank held $494 million in assets.[20]

Historically, the existence of the dual system has provided for innovation in products and services in the industry. The competitive nature of the dual banking system has prompted individual states to be responsive to the needs of their constituent bankers, thereby resulting in new products and powers. When these responsive innovations are multiplied by the fifty state chartering authorities, the result actually belies the "dual" banking system name and creates numerous opportunities for experimentation. Among innovations attributed to the state system are checking accounts, branching, real estate lending, deposit insurance, and trust services.[21] The OCC has also been responsive, increasingly so in recent years, in authorizing additional national bank powers. National banks, through OCC authorization, have introduced or expanded powers in the areas of insurance brokerage, travel agencies, operating subsidiaries, leasing, and data processing services.[22] More recently, OCC interpretations have provided expanded geographical opportunities for national banks (branching powers), as

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16. Johnson, *supra* note 2, at 359.

17. *Id*. at 358-61.

18. Federal Deposit Insurance Corporation, FDIC—Statistics on Depository Institutions Report, Assets and Liabilities, *at* http://www2.fdic.gov/sdi/rpt_Financial.asp (last visited May 15, 2002).

19. *Id*.

20. *Id*.

21. Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORDHAM L. REV. 1133, 1156 (1990).

22. *Id.* at 1157–58.

well as the ability to increasingly engage in additional financial services such as insurance and securities brokerage.[23]

The dual banking system also provides protection against oppressive regulation. Bankers may feel that their regulator is overbearing and that regulatory mandates are negatively affecting their ability to manage their bank. Bank executives sometimes argue that regulators cross the line between regulation of the institution and management of the institution. While these concerns may at times provide a scenario for a charter conversion, in most cases it is likely that the regulator, be it state or national, was addressing legitimate "safety and soundness" concerns, and the banker will not find a safe haven with an alternative regulator. Further, though many state banking departments regulate multi-billion dollar banking companies, not all state agencies have experience with such large and complex institutions. For this reason, some large interstate or international companies may opt for OCC regulation, believing the national regulator will be more understanding of their operational issues and challenges. Alternatively, some bankers prefer a more provincial regulatory approach, expecting local regulators to be more sympathetic to, and familiar with, local economic issues and idiosyncrasies.[24]

II. CURRENT STATE PARITY LAWS

A. Near-Unanimous Adoption of Some Parity Provision, Commonly in Conjunction with "Incidental and Proper" Clauses

Nearly every state has enacted some form of parity provision. In fact, only two states, Iowa and North Carolina, have not.[25] Of the forty-eight states that do have state bank parity statutes, the vast majority of their banking codes also include some type of "incidental and proper" provisions that can also serve to expand upon the powers that are specifically enumerated by the legislatures.[26] These clauses have been subject to both narrow and broad interpretations, not unlike the application of the "incidental powers" clause contained in the National Bank Act.[27] The Chief Counsel of the OCC, Julie L. Williams, has proclaimed a broad interpretation of this clause, describing the "business of banking" authorized for national bank charters as "an evolving activity that could be

23. *Id.* at 1158.

24. *See* Heidi Mandanis Schooner, *Recent Challenges to the Persistent Dual Banking System*, 41 ST. LOUIS U. L.J. 263, 273 (1996); *see also* Michael L. Stevens, Vice President of Education for the Conference of State Bank Supervisors, Editorial: *Examiners Get Thorough Training for a Bank Career*, AM. BANKER, Jan, 25, 2002, at 16.

25. *See* Survey Results, *infra*; *see also* Conference of State Bank Supervisors—2000 Profile of State-Chartered Banking, Table—Wildcard Authority & Parity Statutes—Part I (on file with author).

26. Survey Results, *infra*.

27. *See* Julie L. Williams & Mark P. Jacobsen, *The Business of Banking: Looking to the Future*, 50 BUS. LAW. 783, 786 (1995); *see also* the National Banking Act, 12 U.S.C. § 24 (2000).

responsive to developments in the financial marketplace and the needs of banks' customers."[28] The breadth of the OCC's interpretation of national bank powers is further expressed in her statement that "[t]he incidental powers granted national banks to conduct activities that are 'incidental' to banking are a separate source of authority to undertake activities that are inherently not part of the business of banking."[29] The OCC periodically updates its list of permissible activities. The most recent issuance is dated February 2001.[30]

Williams' confidence in making such statements stems from the United States Supreme Court decision in *NationsBank of North Carolina v. Variable Annuity Life Insurance*.[31] The Court, in considering "whether national banks may serve as agents in the sale of annuities," supported the OCC's determination that this activity was "incidental to the 'business of banking.'"[32] The opinion reiterated the Court's prior holding that "[i]t is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute" and stated that the OCC "warrants the invocation of this principle."[33] The Court further held that "the 'business of banking' is not limited to the enumerated powers" and that the OCC "has discretion to authorize activities beyond those specifically enumerated."[34]

While state bank parity laws are generally thought to provide a level playing field between state and national banks, some of the states have expanded the idea of parity beyond federal institutions. For example, the Michigan parity provision provides its state-chartered banks with powers granted to all financial service providers chartered not just by the federal government, but also by any other state or political subdivision.[35] Further broadening this parity provision is the fact that the term "financial service providers" is not defined. Georgia's parity statute also goes beyond federal financial institutions, and includes "others providing financial services in this state existing under the laws of the United States, other states, or foreign governments."[36]

It was noted earlier that neither Iowa nor North Carolina contain parity provisions in their banking codes. While neither of these states have statutes that specifically provide for parity with respect to national banks, representatives

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28. Julie L. Williams & James F.E. Gillespie, Jr., *The Business of Banking: Looking to the Future—Part II*, 52 BUS. LAW. 1279, 1281-82 (1997).

29. *Id.* at 1282.

30. Office of the Comptroller of the Currency, Activities Permissible for a National Bank (Feb. 2001), *available at* http://www.occ.treas.gov. The preamble to this most recent issuance states: "The business of banking is an evolving concept and the permissible activities of [national banks] similarly evolve over time. Accordingly, this list is not exclusive." *Id*.

31. 513 U.S. 251 (1995).

32. *Id*. at 254.

33. *Id*. at 256 (quoting Clarke v. Sec. Indus. Ass'n, 479 U.S. 388, 403-04 (1987) and Inv. Co. Inst. v. Camp, 401 U.S. 617, 626-27 (1971)).

34. *Id*. at 258.

35. MICH. COMP. LAWS ANN. § 487.14101(2)(b) (1998 & Supp. 2001).

36. GA. CODE ANN. § 7-1-61(a)(1) (1997 & Supp. 2001).

from both states expressed strong opinions that other available legislative provisions serve to provide their respective state banks with all necessary and desired powers.[37] Specifically, Iowa has two provisions that are used in lieu of a parity provision. The first provides that state banks "have and exercise all powers necessary and proper to effect any or all of the purposes for which the state bank is organized."[38] The second and more readily invoked provision provides that Iowa banks may exercise "[a]ll other powers determined by the superintendent to be appropriate for a state bank."[39] According to Donald G. Senneff, Assistant Attorney General and General Counsel to the Iowa Division of Banking, their agency prefers this approach to ensuring competitive parity for two reasons: 1) the state's enumerated powers already provide the ability to engage in the majority of desired activities, and 2) the regulators wanted to avoid conflicts with state laws. He expressed a concern that, in effect, delegating authority to Congress or the OCC could be viewed as a "slap in the face" to the Iowa legislature.[40]

North Carolina statutes provide an even broader powers provision. The enumerated powers list in the "General Powers" article of the state banking code is prefaced with this introduction: "In addition to the powers conferred by law upon private corporations, banks shall have the power . . . ."[41] L. McNeil Chestnut, Special Deputy Attorney General of the North Carolina Department of Justice, points out that this broad provision precludes the need for a parity clause. He notes that, while banks are not required to seek approval prior to exercising new powers, most do so.[42] The North Carolina Commissioner of Banks, in its regulation of the institutions' "safety and soundness," retains the power to oversee, and if necessary, terminate powers or practices deemed unsafe.[43] On an annual basis, the Commissioner publishes a report detailing the various powers engaged in by state banks.[44]

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37. *See* Survey Results, *infra*; Telephone Interview with Donald G. Senneff, Assistant Attorney General and General Counsel, Iowa Division of Banking (Feb. 5, 2002) [hereinafter Senneff Telephone Interview]; Telephone Interview with L. McNeil Chestnut, Special Deputy Attorney General, North Carolina Department of Justice (Feb. 5, 2002) [hereinafter Chestnut Telephone Interview].

38. IOWA CODE ANN. § 524.801(10) (2001).

39. *Id.* § 524.801(14).

40. *See* Senneff Telephone Interview, *supra* note 37.

41. N.C. GEN. STAT. § 53-43 (1999 & Supp. 2001).

42. *See* Chestnut Telephone Interview, *supra* note 37.

43. N.C. GEN. STAT. § 53-104 (1999 & Supp. 2001).

44. *See* State of North Carolina—Commissioner of Banks, 2000 Survey of Revenue Producing Services, *available at* http://www.banking.state.nc.us/forms/banks/20revnsv.pdf (last visited Jan. 31, 2003); *see also* State of Illinois—Office of Banks and Real Estate, Comparison of Powers of Illinois State Commercial Banks and Savings Banks with Powers of Federal Savings Associations and National Banks, *available at* http://www.obre.state.il.us/CPT/COMCL/POSB/TBLCOM/HTM (last visited Jan. 31, 2003).

B. Most Parity Laws Require Some Type of Notice or Approval

Of the forty-eight states with parity laws, thirty-two require the state bank regulatory agency to approve the specific powers before the bank may engage in them.[45] This authority is most commonly vested in the agency's chief executive, and less often, in the agency board.[46] Another eight states, while not specifically requiring approval, provide for notification by the bank, and allow the banking agency to disapprove the practice within a short period of time—generally thirty to sixty days.[47] While not technically an approval process, the effective results can be the same. In another seven states, the state banks may automatically exercise the power held by national banks within their states.[48] In the remaining state (Kentucky), sometimes the power is automatically extended, based on the condition of the bank.[49] Specifically Kentucky, banks with "CAMELS"[50] ratings of 1 or 2 may exercise parity rights without seeking approval.[51]

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45. Survey Results, *infra*.

46. *Id*.

47. *Id*.; *see also* Warsame v. State, 659 A.2d 1271, 1272 (Md. 1995); State v. Union Tank Car Co., 439 So.2d 377 (La. 1983); State v. Thompson, 627 S.W.2d 298 (Mo. 1982). In *Warsame*, a Maryland appellate court examined a state narcotics law, stating that "[a]ny new substance which is designated . . . under federal law shall be similarly controlled . . . unless the Department objects" and further noting that the state agency's ability to "object" to the incorporation of federal provisions into a state statute supported the constitutionality of a Maryland state law. 659 A.2d at 1273. Generally this line of cases points to the need for the legislation to both require state agency approval (or lack of objection) and provide defined criteria for consideration.

48. Survey Results, *infra*. In Nebraska, one of the states that allows for the adoption of national bank powers without the requirement for state agency review, the powers are limited to those available to national banks at the time of the annual update of state law. *See* NEB. REV. STAT. § 8-1,140 (1997 & Supp. 2001). Thus, the Nebraska law is not prospective in nature, and only references existing federal law. In essence then, the Nebraska legislature is arguably only choosing to incorporate federal language by reference, rather than drafting separate state language, for powers that it has deemed appropriate for Nebraska banks.

49. Survey Results, *infra*.

50. *See* Federal Deposit Insurance Corporation, Keeping the Promise: Recommendations for Deposit Insurance Reform, n.4 (Apr. 2001), *at* http://www.fdic.gov. This document describes the components of the CAMELS rating system to include an analysis of **c**apital adequacy, **a**sset quality, **m**anagement, **e**arnings, **l**iquidity, and **s**ensitivity to market risk. Each of these components is rated from one (best) through five (worst), and a composite score is awarded for each institution. CAMELS ratings are generated from on-site examinations of the institutions, generally on an eighteen-month cycle. State banking agencies and the OCC, as the banks' chartering authorities, utilize a range of corrective actions in attempts to rehabilitate troubled institutions. These actions begin with requiring resolutions of the bank's board to make certain changes and can continue if necessary to the closing of the bank. *See, e.g.*, Office of the Comptroller of the Currency, An Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution 27-61 (Jan. 2001), *at* http://www.occ.treas.gov/prbbnkgd.pdf.

51. KY. REV. STAT. ANN. § 287.102(2) (1998 & Supp. 2001).

Thus, in approximately eighty-three percent of instances, the state banking department retains the right to either deny, or disapprove, the desired activity. In essence, these state executive branch agencies have been delegated the power by their state legislatures to determine when federal bank powers should be extended to state banks. In the remaining seventeen of the states, the state legislatures have, under most circumstances, and likely unknowingly or inadvertently, delegated this authority to either Congress, or to the OCC, acting through its interpretation of the National Banking Act.

It is important to note that in twenty of the states that provide for agency approval, the statute calls for extension of the powers by either rulemaking or regulation.[52] The implications of this requirement, and its relevance with respect to the constitutional question of legislative delegation, are further considered in Part III of this Note.

C. Many Provide No Specific Guidance for Approval

Fifteen of the forty states that empower their banking agencies (either always or sometimes) with the authority to deny or disapprove parity requests contain no specific criteria for the decision-making.[53] In essence, the determination is left to the discretion of the state regulator, heightening the constitutional question.[54] Twelve states require a determination that the new power, if granted, will not threaten the "safety and soundness" of the institution.[55] Another eleven of the states, in recognition of the competition between state and national charters, require a consideration of the resulting effect on bank competition and the dual banking system if the power is not extended to state banks.[56] The remaining two states consider the contemplated power's consistency with the state banking code, and the general public interest, in determining whether to allow the practice.[57] The presence or absence of such consideration criteria, and the nature and extent of the criteria, is further discussed in Part III's analysis of the constitutional question.

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52. Survey Results, *infra*.

53. *Id.*

54. Hans. A. Linde, *Structure and Terms of Consent: Delegation, Discretion, Separation of Powers, Representation, Participation, Accountability?*, 20 CARDOZO L. REV. 823, 850 (1999). Linde states that "[u]nconditional delegation of open-ended lawmaking power to a single executive, elected or not, amounts to legislative abdication. It is the essence of modern dictatorships and incompatible with a republican form of government." *Id*. (footnote omitted).

55. Survey Results, *infra*.

56. *Id*. As discussed in Part IV *infra*, these concepts of competition and parity raise a somewhat circular philosophical issue. Namely, state banks, through parity provisions, seek the powers granted to national banks, yet the more homogenized the charters become, the less significance is attached to the inherent characteristics of the dual banking system.

57. *Id.*

D. Most Parity Provisions Override Even Specific State Law Prohibitions

In thirty-five states, if the parity law provisions are met, the federal law preempts even state laws that specifically prohibit particular powers or products.[58] Eight other state parity laws contain only minor exceptions to this blanket preemption.[59] Thus, in only five states did the legislature limit the parity law provisions to allow only for additional powers that are consistent with, and/or not prohibited by, existing state law.[60] These findings appear to represent a significant departure from a regulatory environment that has historically only allowed financial institutions to exercise powers that were specifically enumerated in state law.[61]

The wording used in the various states' parity provisions, with respect to powers otherwise prohibited by state law, varies significantly. In some states, such as Alabama, the intent of the legislature is very clear.[62] The parity clause and the provision overriding contrary state law are contained within the same paragraph.[63] Further, the wording, "[t]he provisions of this section shall take priority over, and be given effect over, any other general or specific provisions of the Alabama law relating to banking to the contrary" leaves little room for debate.[64] Other state statutes are less specific, but just as clear by introducing the parity provision with a phrase such as "[n]otwithstanding other provisions of state law . . . ."[65]

Other statutes are not constructed with such clarity. Indiana's parity provision states, in part: "A bank that intends to exercise any rights and privileges that are: (1) granted to national banks; but (2) *not authorized* for banks under the Indiana Code (except for this section) . . . shall submit a letter to the department describing . . . the requested rights and privileges . . . that the bank intends to exercise."[66] The question is whether the phrase "not authorized" was intended, and should be read, to include "prohibited." Certainly all prohibited powers are not authorized, but it is less clear that the phrase "not authorized" was intended to include previously prohibited powers. In other words, it is clear the provision is meant to grant a power to state banks that had not previously been addressed in state law. It is less clear that this was intended to reach issues that were previously addressed, and proscribed, by the legislature. As this question arises as a product of the unique interplay of dual regulation/legislation, specifically enumerated powers, parity provisions, and the particular wording of

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58. *Id.*

59. *Id.*

60. *Id*. These states are Arizona, Colorado, Massachusetts, Minnesota, and Montana.

61. Johnson, *supra* note 2, at 357.

62. ALA. CODE § 5-5A-18.1 (1975 & Supp. 2001).

63. *Id*.

64. *Id*.

65. *See, e.g.*, ALASKA STAT. § 06.01.020 (2001); CAL. FIN. CODE § 753(b)(1) (1999 & Supp. 2002); IDAHO CODE § 26-1101(3) (2000 & Supp. 2001); 205 ILL. COMP. STAT. ANN. 5/5(11).

66. IND. CODE § 28-1-11-3.2(b) (1998 & Supp. 2001) (emphasis added).

the Indiana Code, there is no definitive answer to this question. Subsection (f), following four paragraphs later, provides additional guidance: "The exercise of rights and privileges by a bank in compliance with and in the manner authorized by this section is not a violation of any provision of the Indiana Code."[67] While this wording appears to reach previously prohibited powers, a simple phrase such as "notwithstanding any other state law" would have been clearer.

In any event, the delegation of authority that allows state banks to engage in a power, or offer a product, that was previously specifically prohibited by state law, appears to represent the strongest case for the position that at least some state bank parity laws represent an unconstitutional abdication of lawmaking responsibility by state legislators.

E. Parity Provisions Have Been Used to Extend a Variety of Bank Powers

Through the years, parity provisions have been invoked to provide a wide variety of previously unauthorized powers to state banks.[68] Many have afforded additional options or further definitions for core bank products and services. For example, they have provided for amendments and/or additions to the types of lending activities in which banks may engage, as well as adjustments to the calculation of the banks' legal lending limits.[69] The lists of statutorily acceptable investment securities for bank purchase have also been expanded,[70] and some states have expanded the banks' ability to purchase bank-owned life insurance.[71] The provisions have also been used to expand the banks' ability to invest in subsidiaries, and to expand the powers in which bank subsidiaries may engage.[72] These types of state statute amendments that extend federal powers to state banks would be viewed as falling within a historically narrow interpretation of powers that are incidental to the business of banking.

The parity provisions have also been used to expand powers that were traditionally outside of the scope of the business of banking.[73] Common among these are additional powers relative to insurance sales, securities brokerage, and investment advice. Additional powers not previously enumerated by state legislatures include courier services, travel agency services, real estate holdings and leasing, tax preparation service, title insurance powers, and the ability to purchase Federal Home Loan Bank Stock.[74] While not necessarily incidental to the business of banking, these powers and products have come to be considered complimentary to the basic financial services previously offered by banks, thus satisfying the parity provisions of many states, and allowing for greater equality

67. *Id*.
68. *See* Survey Results, *infra*.
69. *Id*.
70. *Id*.
71. *Id*.
72. *Id*.
73. *Id*.
74. *Id*.

with the national charter.

III. Constitutionality of State Bank Parity Laws

A. Concerns for Abdicating Lawmaking to the Federal Legislature and/or Regulators

Despite the fact that "all enactments enjoy a strong presumption of constitutionality,"[75] an argument can be made that state bank parity laws, which extend the powers of national banks to state-chartered banks, represent an unconstitutional delegation of lawmaking powers by a state legislature to Congress. The primary argument is that parity laws go well beyond the generally accepted practice of the incorporation of certain federal language, and amount to the delegation of authority that is significant and integral to the states' regulation of their financial institutions. In practice, this question of delegation reaches even further since it is the OCC, rather than Congress, whose interpretations and actions often expand national bank powers. This concern is heightened when the powers are extended automatically, without the satisfaction of specified criteria, and heightened further when they override a theretofore-specific prohibition in state law.

The United States Supreme Court, regarding the constitutionality of congressional delegation of legislative powers, considers whether Congress "has attempted to abdicate, or to transfer to others, the essential legislative functions with which it is vested by the Constitution."[76] While the applicability of the analysis of congressional delegation to the issue of state legislative delegation has been debated, in the absence of a Supreme Court opinion directly on point, such precedent remains "entitled to respectful attention and may be relied upon."[77] The questions remain, "what constitutes 'essential legislative functions?'" and further, "what type of legislative delegation amounts to an abdication of these functions?" When state legislators have traditionally provided specifically enumerated bank powers, it can at least be argued that the maintenance of this list is an "essential legislative function." Further, the delegation of the ability to expand this list of approved powers to include activities that were previously specifically prohibited by prior legislation can be argued to represent an abdication of legislative function and responsibility.

Many of the state supreme court decisions that have considered the

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75. State v. Gill, 584 N.E.2d 1200, 1201 (Ohio 1992). *See also* Indep. Cmty. Bankers Ass'n of S.D. v. State By & Through Meierhenry, 346 N.W.2d 737, 739 (S.D. 1984) (stating that "[a]ny legislative act is accorded a presumption in favor of constitutionality and that presumption is not overcome until the unconstitutionality of the act is clearly and unmistakenly shown and there is no reasonable doubt that it violates fundamental constitutional principles.").

76. Currin v. Wallace, 306 U.S. 1, 15 (1939).

77. Devlin, *supra* note 7, at 1220 (cautioning against consideration of federal precedent when the state constitutional provisions were uniquely structured, reflecting local history or culture, and not consistent with typical constitutional language).

constitutional question of whether legislative delegation by state legislators to Congress or federal agencies was constitutional have involved the simple incorporation of some federal legislative language in state law.[78] In such cases, the courts have generally upheld the constitutionality of the state law on the grounds that reference to a federal definition (in this case, in the state's revenue code) "does not constitute an unconstitutional delegation of legislative power where the prospective recognition is only incidental to the administration of the statute . . . and not likely to frustrate the purpose of the statute."[79] Similar results have been reached when the deference to federal law was only with respect to the definition of terms, such as "bank holding company."[80] This type of language incorporation exercised by state legislatures can serve to ensure consistency and can reduce misunderstandings, especially in areas of interstate commerce. Adoption of certain standard definitions and terminologies can promote efficiency without sacrificing or abdicating state lawmaking powers or state autonomy.

However, while from a practical standpoint it can be argued that it is both expedient and convenient to tie state bank powers to federal powers, it also introduces a very slippery slope. In rebuking what it found to be an unconstitutional delegation of state lawmaking power to the federal government in a labor contract matter, the court in *DeAgostina v. Parkshire Ridge Amusements* stated that "[a]ssuming . . . the means adopted is more practical and convenient than the establishment by the state of its own code authorities modeled after the federal system, that alone presents no justification for what has been done" and warned "if the state's power to delegate governmental functions to a foreign agency is sanctioned, there can be no legitimate limits to its exercise."[81] This statement recognizes potential pitfalls of the temptation to enact state legislation that, by incorporating substantive federal law, puts the value of convenience and timeliness above the need to address the specific

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78. First Fed. Sav. & Loan Ass'n of New Haven v. Connelly, 115 A.2d 455, 492 (Conn. 1955); State v. Johnson, 173 N.W.2d 894, 895 (S.D. 1970).

79. Miller v. State Dept. of Treasury, 188 N.W.2d 795, 808 (Mich. 1971) (holding that the simple adoption of the federal calculation of "taxable income" did not amount to an abdication of lawmaking by the state legislators).

80. *Indep. Cmty. Bankers Ass'n*, 346 N.W.2d at 743. In the case, the definition used by the court was two and one-half pages long, arguably reason enough to incorporate by reference rather than spell out similar wording in the state law. *Id*. at 744. Interestingly, the plaintiff in this case also challenged the constitutionality of the delegation because the state law referred to "the Bank Holding Company Act of 1956, *as amended*." *Id.* at 743 (emphasis added). That court, citing *State v. Julson*, 202 N.W.2d 145 (N.D. 1972), distinguished between the phrases "and all amendments" and "as amended," and declared that "as amended" referred to the past tense, meaning that it included amendments to the Bank Holding Company Act enacted prior to the incorporation of this definition into state law. *Indep. Cmty. Bankers Ass'n*, 346 N.W.2d at 743-44. Thus the incorporation of a federal law, *as amended*, into a state statute, is not necessarily a prospective delegation, and may be limited to then-existing federal law.

81. 278 N.Y.S. 622, 629-30 (N.Y. Sup. 1935).

legislative issues of the individual state.

The prospective nature of the delegation afforded by parity provisions provides additional pause as in most cases the state legislature is providing for the adoption of powers not yet enacted by Congress. This was addressed by the court in *Independent Community Bankers Ass'n* when it stated, "[s]tatutes adopting laws or regulations of . . . the federal government . . . effective at the time of adoption are valid, but attempted adoption of future laws, rules or regulations of . . . the federal government . . . generally have been held unconstitutional."[82] The Washington Supreme Court echoed this position in *State v. Dougall* when it declared a state narcotics law unconstitutional as it permitted "future federal designation . . . by means of Board inaction or acquiescence."[83] The vast majority of the states' bank parity laws provide for true prospective delegation, as they do not limit the provisions only to existing federal legislation or regulations, thus heightening the constitutional question.[84]

A further concern in bank regulation exists due to the aggressive and arguably liberal interpretations of national bank powers being extolled by the OCC. In effect, such liberal interpretations extend the abdication issue one step further—from the federal legislature to an agency of the Department of the Treasury. National bank powers can arise from one or more of three means: clear legislative authority, prescribed rulemaking procedures by the OCC,[85] or through administrative fiat exercised by the Comptroller. These OCC interpretations can result, and arguably have resulted, in the automatic extension of a power to a state bank that was contemplated neither by state nor federal lawmakers. Indication that the OCC has interpreted the National Banking Act in a manner not foreseen by Congress was evidenced in a 1994 congressional reprimand of the OCC for "'inappropriately aggressive' preemption."[86]

The Louisiana Supreme Court, in *State v. Rodriguez*, addressed the constitutionality of a state law that effectively delegated authority to an agency of the federal government.[87] The state law stated, "The secretary of the

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82. 346 N.W.2d at 744 (quoting Schryver v. Schirmer, 171 N.W.2d 634, 636-37 (S.D. 1969)); *see also Miller*, 188 N.W.2d at 801 ("It is well settled that incorporation by reference of an existing Federal law in a state statute does not render that statute constitutionally infirm").

83. 570 P.2d 135, 138 (Wash. 1977).

84. One exception, as noted *supra*, note 48, is the Nebraska parity provision that extends only federal powers existing at the time of the enactment of state law. Another is the current South Dakota parity statute that seeks to extend parity only to federal "powers and authorities conferred as of January 1, 1999." S.D. CODIFIED LAWS § 51A-2-14.1 (1990 & Supp. 2001). While these two states' laws appear to avoid prospective delegation to federal law, they also appear to minimize the utility of the parity provisions as a means of providing for statutory amendments between state legislative sessions.

85. *See* Office of the Comptroller of the Currency, OCC Standards for Developing Regulations (Nov. 20, 2001) *available at* http://www.occ.treas.gov.

86. Stacy Mitchell, *Rogue Agencies Gut State Banking Laws*, THE NEW RULES, Fall 2001, at 4 (quoting Congress's 1994 reprimand at pp. H6625-H6642 of the Congressional Record).

87. 379 So.2d 1084 (La. 1980).

Department of Health and Human Resources shall add a substance as a controlled dangerous substance if it is classified as a controlled dangerous substance by the Drug Enforcement Administration of the United States government."[88] While at first glance this statement appears to be a delegation to the secretary of the state agency, the word "shall" effectively ties that official's hands. The state law provides for the automatic inclusion of narcotics if designated by the DEA. In striking the law down as unconstitutional, the court said that the legislature may confer powers "upon executive agencies if it supplies adequate standards to execute legislative policy; however, it cannot surrender the legislative power itself to determine what the law shall be."[89] In this criminal case, the prospective nature of the delegation was significant. Once the DEA added the controlled substance to its list, Louisiana likewise added it, and introduced state legislation to incorporate the substance into their criminal code. However, the plaintiff was arrested and charged with possession between the time the substance was added to the agency's list and the time it was legislatively incorporated into state law. Upon these facts, the prosecution was dismissed.[90]

In 1994, the Texas Department of Banking ("TDB") found itself in the unusual position of promoting a revised parity statute in an effort to *limit* the ability of state banks to undertake powers authorized for national banks. The TDB's efforts were due to the existence of a state constitutional provision, added in 1984, that stated, "A state bank . . . notwithstanding any other provision of this section, has the same rights and privileges that are or may be granted to national banks of the United State domiciled in this State."[91] In her testimony before the Texas House of Representatives, former TDB Commissioner Catherine A. Ghiglieri stated the agency's position that "state bank regulation would be chaotic and unpredictable if Section 16(c) is fully self-activating, and would damage the dual banking system."[92] Conversely, she noted that if, instead, the constitutional provision was viewed as "fully permissive, the Legislature through laws, . . . or the Banking Commissioner through opinions or policies would have to authorize the activity before a state bank could exercise a national bank right."[93] Ultimately a parity provision was enacted that provided a means for state banks to "have the same rights and privileges as national banks" while establishing "an orderly system of implementation . . . essential to regulatory control."[94]

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88. *Id*. at 1085.

89. *Id*. at 1087.

90. *Id*.

91. TEX. CONST. art. XVI, § 16(c).

92. *Proposed Legislation to Modernize the Texas Banking Code of 1943, Supplement to Testimony Presented to the Committee on Investments & Banking, Texas House of Representatives* (Sept. 22, 1994) (written testimony of Catherine A. Ghiglieri) (on file with author).

93. *Id*.

94. *Id*.; TEX. REV. CIV. STAT. ANN. art. 342-3.010 (1973 & Supp. 1996).

B. Concerns for Abdicating Lawmaking to Executive Branch Officials

Parity provisions that delegate the ultimate determination of the extension of federal banking powers to officials within the executive branch of state governments, specifically the state banking departments, raise another constitutional issue. These provisions can serve, in varying degrees according to their wording and parameters, to provide state banking agencies with legislative-type authority. This concern is exacerbated by parity laws that provide little or no criteria to be considered by the agency in determining whether or not to allow for the extensions of bank powers. The lack of established consideration criteria raises the question of the line between administrative and legislative powers. In discussing this issue, the Kansas Supreme Court noted that "[a]dministrative power is the power to administer or enforce a law, as opposed to the legislative power to make a law," and the determination between the administration and the making of law "depends upon the amount of specific standards included within the delegation."[95] The importance of legislative standards for the executive agency was echoed by the high court of New York when it found "no constitutional prohibition against the delegation of power, with reasonable safeguards and standards, to an agency . . . to administer the law as enacted by the legislature."[96] It is necessary, of course, that executive agencies retain sufficient latitude to effectively administer statutes, and it is clearly impossible for state legislative bodies to anticipate all potential ramifications of newly enacted legislation. While this inability to predict all potential ramifications of new statutes presents an argument for legislation lacking in specificity, the New Jersey Supreme Court cautioned that while "exigencies of modern government have increasingly dictated the use of general, rather than minutely detailed standards" in legislation, it is necessary that statutes "provide adequate restraints on the discretion" of the agency.[97]

While delegation of certain administrative duties and interpretations to executive branch agencies is commonplace,[98] the delegation of the types of determinations encompassed by parity provisions is arguably different. Delegation within parity provisions does not involve simply allowing the agencies the authority to draft policies and procedures for the implementation of statutes. Instead, the agencies are given the charge of determining whether or not to, in effect, augment and expand powers that are otherwise, and have historically been, specifically enumerated.

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95. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n, 956 P.2d 685, 707 (Kan. 1998). The court went on to say that, with respect to criteria provided to administrative agencies, "the standards only have to be sufficiently reasonable and definite." *Id.* at 711.

96. Boreali v. Axelrod, 517 N.E.2d 1350, 1354 (N.Y. 1987).

97. Roe v. Kervick, 199 A.2d 834, 857 (N.J. 1964).

98. *See* Curry v. State, 649 S.W.2d 833, 835 (Ark. 1983) (noting that "the limitation against the delegation of lawmaking power does not prevent the General Assembly from authorizing boards or commissions to determine facts upon which the law would be put into execution").

An argument in favor of this type of delegation is found in *Citizens*, a case unrelated to banking, where the court noted that a "modern trend, which we ascribe to, is to require less detailed standards and guidance to the administrative agencies in . . . areas of complex social and economic problems."[99] Certainly the regulation of banks can be argued to encompass complex social and economic problems. Further, experienced bank regulators are undoubtedly better qualified than are state legislators to determine which bank powers and products are prudent. These regulators are also much more familiar with the federal powers that might become subject to parity provisions. However, this can be argued to be the case in many legislative matters. Certainly state health officials understand medical matters more fully than legislators. It is in recognition of this fact that our legislators do not draft legislation in vacuums, but instead solicit and consider significant input from industry professionals and community groups. State legislatures cannot simply delegate all lawmaking authority in complex matters in the interests of efficiency and convenience. Though not dealing specifically with the issue of delegation, the United States Supreme Court, in *Immigration and Naturalization Service v. Chadha et al.*, cautioned, "the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution. Convenience and efficiency are not the primary objectives . . . of democratic government."[100]

Even in the cases where the state legislatures have included criteria for consideration by the regulatory agency, some of the criteria tend to be somewhat vague and nebulous. Though the phrase "safety and soundness" might be argued to fit this description, those in the bank regulatory profession view "safety and soundness" as a clear, concrete measure of a bank's operational integrity, performance, and condition. Many well-defined criteria are considered in determining whether a bank is operating in a safe and sound manner.[101] Further, all bank regulators utilize a standard component rating system known as "CAMELS" in assessing the current and future risk associated with banks' operations.[102] Thus, if the ability to adopt additional power through parity is based on the determination of the "safety and soundness" of the activity, well defined measures are available to banking agencies. It is important to note that "safety and soundness" analysis is applied to both the overall condition of the

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99. 956 P.2d at 711.

100. 462 U.S. 919, 944 (1983); *see also* Royce C. Lamberth, *Reflections on Delegation in the Chevron Era*, 56 FOOD & DRUG J. 11, 13 (2001) (stating, "[o]n the one hand, delegation is a practical necessity for our country; on the other hand, it is at odds with our democratic roots").

101. *See* Sharpe, *supra* note 5, at 236-44 (describing the prescribed standards to be considered in evaluating "safety and soundness," as required by the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242 (1991) (codified at 12 U.S.C. § 1831a (2000)). Included among the factors that must be considered are: internal controls; loan documentation, underwriting, and quality; interest rate risk; asset growth; earnings; capital adequacy, and, other measures deemed appropriate. Sharpe, *supra* note 5, at 236-37.

102. *See supra* note 50.

bank, and to particular activities engaged in by the bank.[103] When a bank engages in an "unsafe and unsound" practice, it is subject to an order from its regulator to "cease and desist" from that practice.[104] When the overall condition of the bank deteriorates and is deemed "unsafe and unsound," this will be reflected in the bank's CAMELS rating, and will prompt appropriate regulatory action.[105] By providing for state banking agency consideration of "safety and soundness" issues prior to granting powers through parity, state legislatures have attempted to ensure that powers are only extended when they represent a prudent banking practice, and only to banks that are in a condition that is conducive to undertaking new powers.

On the other hand, some of the criteria included for consideration in state parity laws, such as "public convenience and necessity," "competitive equality," and "public interest," while relevant, do not provide very specific guidance. Thus, even when such criteria are applicable, determinations by the agency remain effectively discretionary. The level of discretion afforded the agency has been a primary determining factor in state court decisions that have considered this constitutional issue. Courts have looked for specific criteria to be evaluated by the executive branch agency. In *Curry v. State*, the Arkansas Supreme Court found delegation to an administrative agency constitutional because the statute enumerated several criteria to be considered in determining whether federal designations for controlled substances should be incorporated into state actions.[106] In contrast, the Ohio Supreme Court in *State v. Lyman* found an unconstitutional delegation stating, "it is quite clear that no standards . . . were incorporated in the statute, or so far as we can discover, in any other law."[107]

Though the United States Supreme Court has not specifically addressed this constitutional issue as it relates to state legislatures, insight can be gleaned from their decisions regarding similar congressional questions. While in *Panama Refining Co. v. Ryan*, the Court found unconstitutional delegation, stating, "Congress . . . declared no policy[,] . . . established no standard[,] . . . laid down no rule[,] . . . no requirement, no definition of circumstances and conditions" for application,[108] this decision is not consistent with the majority of the Court's opinions. The prevailing position both before and after *Panama* provides Congress more latitude, requiring only that Congress "lay down . . . an intelligible principle to which the person or body authorized to [make rule] is directed to conform . . . ."[109] Further, the Court has determined "[i]t is not necessary that Congress supply administrative officials with a specific formula for their guidance in a field where flexibility and the adaptation of the congressional policy to infinitely variable conditions constitute the essence of the

103. *See* Sharpe, *supra* note 5, at 222-23.
104. *Id*. at 223-24.
105. *Id*.
106. 649 S.W.2d 833, 836 (Ark. 1983).
107. 1987 WL 19033, 5 (Ohio Ct. App. 1987).
108. 293 U.S. 388, 430 (1935).
109. Hampton & Co. v. United States, 276 U.S. 394, 409 (1928).

program."[110]

This question of delegation to executive agencies can be of particular concern in certain political environments. In most states, the senior officials of the state banking agencies are subject to political appointments, and often change based on gubernatorial elections.[111] This is especially true of the agency's chief executive officer, but can also extend to chief deputy and general counsel positions. When agencies experience significant executive-level turnover, they can lose valuable "institutional knowledge."[112] The loss of this perspective that was previously provided by such experience and expertise would limit the agency's ability to make prudent decisions that are sensitive to longer-term industry and regulatory concerns.[113] This type of agency turnover at the decision-making level can minimize the argument for providing significant latitude when legislation deals with "areas of complex social and economic problems,"[114] since the assumed expertise and experience may be lacking.

As noted earlier, the fact that many of the states' parity laws provide for extension of federal powers only through administrative regulation or rulemaking may, to a certain extent, obviate concerns arising from the delegation to executive agencies. Certainly this action by the respective state legislatures clearly bolsters the argument that sufficient parameters and standards are in place. And while the rulemaking/regulation process is not entirely consistent from state to state, its requirements for publication, public hearings, and other democratic features at least afford a significant safeguard against the exercise of administrative fiat by the executive branch.[115] The existence of such a rulemaking requirement was cited as persuasive by the Missouri Supreme Court in their finding of constitutional delegation to an administrative agency in *State v. Thompson*.[116] This position was echoed by the supreme courts of both

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110. Lichter v. United States, 334 U.S. 742, 785 (1948).

111. Conference of State Bank Supervisors, 2000 Profile of State-Chartered Banking, Table—State Bank Supervisors—Part I (on file with author).

112. Sen. George V. Voinovich, *Crisis in the Federal Workforce: Challenges, Strategies, and Opportunities*, 48-OCT. FED. LAW. 30, 31 (2001) (discussing the potential loss of "an unquantifiable wealth of experience," or "institutional knowledge," by the federal government in the next few years).

113. *Id*.

114. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n, 956 P.2d 685, 707 (Kan. 1998).

115. Arthur Earl Bonfield, *The Federal APA and State Administrative Law*, 72 VA. L. REV. 297, 316 (1986) (noting that the model state administrative law followed the general notice and comment principles as the federal law). The article describes the model law as being "modeled on the representative, political process of the legislative branch of government. In theory, agency rulemaking in a representative, popularly responsible government, should produce the same result as if the action in question has occurred through action of the legislature." *Id.* at 319 (footnotes omitted).

116. 627 S.W.2d 298, 301 (Mo. 1982). This court further noted the importance of the statute's language that listed "eight specific factors expressed as mandatory considerations . . . in making a determination" of whether to add certain substances to its controlled substance schedules, and an

Alabama and Minnesota, in *Ex parte McCurley*[117] and *State v. King*,[118] respectively.

An issue involving the interplay among state bank powers, delegation, and constitutionality recently arose in Georgia, stemming from a 1997 approval by the Georgia Department of Banking and Finance ("GDBF"). At that time, the agency's commissioner, relying on the state's "incidental and proper" provision rather than its parity clause, approved the acquisition of a real estate brokerage business by a state bank.[119] The commissioner's decision was based, in part, on the fact that "federal thrifts, federal credit unions . . . and banks in twenty-five other states" were so authorized.[120] In early 2002, the Georgia Association of Realtors argued that Georgia state banks may not lawfully engage in real estate brokerage services, and cited the Georgia Supreme Court case *Independent Insurance Agents v. Department of Banking & Finance*[121] in support of their position.[122] *Independent Insurance Agents* involved a GDBF decision to authorize a state bank to operate an insurance agency on the basis of Georgia's then-existing "incidental and proper" provision.[123] The provision authorized "all incidental powers as shall be *necessary* to carry on the banking or trust business."[124] Invoking the principle of *ejusdem generis*,[125] the court determined that the insurance brokerage business, though arguably "convenient or useful" for the bank, was not sufficiently "similar in nature" to an "express power" to meet their interpretation of the "necessary" test.[126] Indicating concerns with constitutional issues relative to separation of powers and delegation authority, the court concluded by saying that if insurance powers for banks are needed, "the proper forum to obtain this power is the legislature."[127]

Leslie A. Bechtel, Deputy Commissioner for Legal and Consumer Affairs

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additional three findings to add a substance to Schedule IV. *Id.* at 302. The importance of the inclusion of these "statutory standards" was emphasized by the court. *Id*. at 302-03.

117. 390 So.2d 25 (Ala. 1980).

118. 257 N.W.2d 693 (Minn. 1977).

119. *See* Telephone Interview with Leslie A. Bechtel, Deputy Commissioner for Legal & Consumer Affairs, Georgia Department of Banking and Finance (Feb. 19, 2002) [hereinafter Bechtel Telephone Interview].

120. Notice accompanying Petition for Declaratory Ruling to Department of Banking & Finance, Georgia Association of Realtors, Georgia Bankers Association, & Community Bankers Association of Georgia (Feb. 8, 2002), *available at* http://www.ganet.org/dbf/dbf.html (on file with author).

121. 285 S.E.2d 535 (Ga. 1982).

122. *See* Bechtel Telephone Interview, *supra* note 119.

123. *Id*. at 536.

124. *Id*. (emphasis added).

125. This term means "[a] canon of construction that when a general word or phrase follows a list of specific persons or things, the general word or phrase will be interpreted to include only persons or things of the same type as those listed." BLACK'S LAW DICTIONARY 535 (7th ed. 1999).

126. *Indep. Ins. Agents*, 285 S.E.2d at 537.

127. *Id*.

with the GDBF, notes that the holding in *Independent Insurance Agents* was argued despite the fact that Georgia's "incidental and proper" provision has changed significantly since 1982.[128] The current law grants "all powers necessary, *convenient*, or *incidental* to effect any and all purposes for which the bank or trust company . . . is organized."[129] The statute further includes such powers needed to "carry on banking, trust, or other activities determined by the commissioner to be *financial in nature or incident or complementary to such financial activities*,"[130] clearly broadening the legislative grant of power. Despite the questionable precedent of *Independent Insurance Agents* due to the change in statutory language, and in part to avoid jeopardizing the GDBF's future ability to expand state bank powers, the Department issued a declaratory ruling stating that it would not approve additional real estate brokerage activities until such powers are granted to national banks.[131] In the event national banks are granted this power, the GDBF can approve the extension of real estate brokerage powers through its parity provision as a means of remaining competitive with the national charter.

IV. PHILOSOPHICAL AND PUBLIC POLICY ISSUES

A. States' Interest in Limiting Bank Powers

Banks gather money in the form of customer deposits and invest that money in loans, securities, real estate, etc. These institutions also benefit from the availability of federal deposit insurance, a safety net that assists them in attracting deposits. Because the citizens of each state are placing their trust and deposits with banks, a compelling state concern arises, and every state maintains banking laws and banking agencies for the purpose of promoting prudent banking practices. A primary means of controlling the level of risk inherent in banking has been limitations of permissible activities, products, and services. Thus, the parity issue has significant ramifications on the safety of the banking system. It is essential that parity provisions do not promote "an unproductive competition in laxity" among regulators.[132] Indeed, in recognition of the danger of burgeoning bank powers, and in the wake of the numerous thrift and bank failures of the 1980s and early 1990s, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), which curtailed the ability of state legislatures and banking departments to expand state bank

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128. *See* Bechtel Telephone Interview, *supra* note 119.

129. GA. CODE ANN. § 7-1-261(11) (1997 & Supp. 2001) (emphasis added).

130. *Id*. (emphasis added).

131. *See* Bechtel Telephone Interview, *supra* note 119; Declaratory Ruling of the Georgia Department of Banking & Finance (Feb. 13, 2002) *available at* http://www.ganet.org/dbf/dbf.html.

132. Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 680 (1988) (referring to the competition for charters between state and national regulators).

powers.[133] These concerns remain today, and are arguably heightened by subsequent federal legislation that has brought additional competition for banks and resultant increased pressure on bank earnings performance.

Financial institution failures in the early 1980s were in large part due to institutions actively pursuing newly granted powers without the necessary expertise to adequately assess and control risk.[134] Many thrifts entered into the commercial real estate development business, departing from the safer but generally less profitable home mortgage industry.[135] With the advent of new available powers for banks, particularly insurance and securities underwriting, it will be necessary for regulators to ensure that institutions do not exercise these powers without a clear understanding of the risk.[136] Expansion of powers by means of parity provisions in such an environment raises concerns that did not exist prior to this period of unprecedented expansion of bank powers that has come to be known as "financial modernization."[137]

While parity provisions can be viewed as something akin to "emergency legislation," with the potential for legislative review and possible revision during the succeeding legislative session, practice has not borne this out. Most state legislatures do not meet throughout the entire year. Thus while these parity provisions provide for immediate response to federal legislative initiatives, none of the parity provisions require the legislatures to ratify the adopted powers, thereby statutorily adding them to the previously enumerated list of permissible activities.[138] California's law comes the closest, promoting legislative review/action by including a "sunset" provision. The statute provides that "any regulation . . . shall expire . . . on December 31 of the year following the calendar year in which it became effective."[139] Thus, legislative action is necessary if the grant of power is to be permanent. In addition, some of the states' parity laws include procedures to promote legislative review of powers granted through

133. Pub. L. No. 102-242 (1991) (codified at 12 U.S.C. § 1831a (2000)).

134. Federal Deposit Insurance Corporation, An Examination of the Banking Crises of the 1980s and Early 1990s 9-10 (1997), *at* http://www.fdic.gov/bank/historical/history/vol1.html (describing legislative initiatives that, in hindsight, were poor public policy, as they focused on deregulating "the product and service powers of thrifts and to a lesser extent of banks . . . generally unaccompanied by actions to restrict the increased risk taking they made possible").

135. *See* Markham, *supra* note 3, at 245.

136. *See generally* Federal Reserve Bank, Chicago Supervision & Regulation Department, FINANCIAL MODERNIZATION—A GUIDE TO THE GRAMM-LEACH-BLILEY ACT (2000) (on file with author). In the report's cover letter dated April 6, 2000, addressed to all Seventh District state member banks and bank holding companies, John J. Wixted, Jr., Senior Vice President of the Federal Reserve Bank of Chicago, summarized the act as permitting "banks, insurance companies, securities firms, and other financial institutions to affiliate under common ownership and offer their customers a complete range of financial services which were previously prohibited." *Id*.

137. A search of Westlaw's Text & Periodicals Combined (TP-ALL) database yielded 389 hits for the term since January 1, 1996. (last viewed Feb. 23, 2002).

138. *See* Butler & Macey, *supra* note 132, at 705; Survey Results, *infra*.

139. CAL. FIN. CODE § 753(c)(4) (1999 & Supp. 2002).

parity. This legislative review is generally accomplished by the submission to the legislature of a summary of parity actions taken by the state banking department during the prior year.[140] In practice, once a bank is granted powers, the subsequent rescission of those powers could result in significant financial hardship on the bank. This is especially true since virtually all of these adopted powers would involve contractual relationships with customers of the bank, and in many cases third-party providers and servicers. For instance, if a bank were granted the right to conduct some type of real estate development, contractual relationships, both long and short term, would arise among potential tenants, architecture firms, construction management firms, real estate brokerage firms, telecommunications firms, utilities, and a myriad of others. In addition, prior to entering a new venture, the bank would have to expand its staff to include employees with particular expertise in the business. These personnel expenses would be just one of many "sunk costs" incurred by the bank in undertaking a new operation. For these reasons, it is simply not reasonable to contemplate that power and authority, once granted to a bank, can readily be rescinded.

B. Necessity and/or Desirability of Consistency in State Laws Nationwide

As noted, in many respects, the parity laws "are neither similar nor uniform."[141] Since the primary responsibility of each of the regulators is to ensure safe and sound bank operations, is this inconsistency illogical? Is it necessary or even desirable for the states to consider adopting model legislation as suggested by Johnson?[142]

Organizational and corporate structures differ from one interstate banking organization to another. From the company's perspective, strategic and operational planning is much more efficient when the company does not have to consider separate and different legislative and regulatory constraints in each state.[143] In an interstate environment, the state charter can only remain competitive with a national charter by providing a "seamless regulatory" environment.[144] Anything less would preclude the necessary "level playing field." Recognition of this principle is evidenced in agreements among state banking agencies made in efforts to streamline interstate regulation:

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140. *See, e.g.*, KAN. STAT. ANN. § 9-1715 (1991 & Supp. 2000); MASS. GEN. LAWS ANN. ch. 167F, § 2(31) (1997 & Supp. 2001); N.H. REV. STAT. ANN. § 394-A:7(IX) (1998 & Supp. 2001).

141. Johnson, *supra* note 2, at 402.

142. *Id.*

143. *See* Press Release, Conference of State Bank Supervisors, Announcement of the Adoption of the Nationwide Cooperative Agreement (July 25, 1997) (on file with author). The press release hailed the adoption of a "single regulatory point of contact at both state and federal levels," and the provision by the agreement of "increased regulatory certainty and more uniformity."

144. *See* Frequently Asked Questions, Legislative Affairs, Conference of State Bank Supervisors website, *at* http://www.csbs.org/government/legislative (last visited Feb. 17, 2002) (describing the "single point of contact" concept as setting up a "seamless system of supervision for a state chartered bank that wishes to operate interstate.").

> The goals of the parties of this Agreement are to promote a comprehensive nationwide system for safety and soundness of financial institutions, to supervise and examine multi-state banks in cooperation with other states, to foster effective coordination and communication among the parties to facilitate the process of supervision and examination with the least burden to multi-state banks, and to enhance responsiveness to local needs and interests in an interstate banking and branching environment.[145]

The question of "seamless regulation" is of concern for all interstate banking companies, but it is of particular concern for the companies that chose to operate individual state-chartered banks in more than one state. Each bank subsidiary in a multi-bank holding company maintains its own bank charter, and is thus subject to regulation and examination by its individual chartering authority (state agency or the OCC). Consistency of laws, regulations, and regulatory practices is an integral consideration. Absent the type of agreement discussed above, the national bank charter would hold a significant competitive advantage over the state charter.

While states must be cognizant of the operational requirements of banks, and while the survival of the dual banking system requires that national and state charters be competitive, the decision to provide seamless regulation could arguably also lead to the demise of the dual banking system. As noted in Part I, one of the primary advantages of the dual banking system throughout banking history has been the innovation fostered by its competitive nature. This innovation has been a product of the existence of fifty individual state banking codes and state regulators, in addition to the federal banking laws and regulator. The more the state regulators and state banking codes become homogenized, the less justification there is for the continuation of the dual banking system. In a 1994 law review article, Professor Norman Silber argued that too much deference to federal law by state legislatures amounts to "one small step backward for federalism, and a move forward for federalization."[146]

CONCLUSION

Nearly all states have recognized the need for the adoption of state bank parity laws. Failure to do so, or to apply "incidental and proper" provisions in the absence of parity laws, can result in an unlevel playing field with respect to national banks.

Though most states have parity provisions, the various laws are quite

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145. Article I, Section 2.2 of the Nationwide Cooperative Agreement coordinated by the Conference of State Bank Supervisors to foster regulatory cooperation among state banking agencies. (on file with author).

146. Norman Silber, *Why the U.C.C. Should Not Subordinate Itself to Federal Authority: Imperfect Uniformity, Improper Delegation, and Revised Section 3-102(C)*, 55 U. PITT. L. REV. 441, 444 (1994).

different in their drafting and application. While the need for a model parity law can be debated, it is logical that certain parity law provisions should be consistent given the collective states' interest in promoting safe and sound banking practices. Among the issues that would benefit the system through greater consistency are the extent and applicability of state banking agency review, criteria and procedure for the review, and treatment of theretofore prohibited powers.

While arguments can be made that parity laws result in unconstitutional delegation of lawmaking by state legislatures, contrary positions are also compelling. An argument for the parity provisions is the need for banking organizations to be afforded new powers in a timely and efficient fashion. It is necessary that state-chartered financial institutions remain functionally competitive with their federal counterparts. The opposite position is that, particularly in an era of rapid "financial modernization," a more thoughtful, legislative consideration of the associated risks might be more appropriate. Further, state supreme court cases, while endorsing the constitutionality of simple definitional references to federal law, have not endorsed deference to federal law in substantive matters. And while state high courts have held constitutional legislation that delegates certain authority to executive agencies, this endorsement has generally been based, in part, upon the existence of sufficient criteria for consideration by the state agency. In any case, state bank parity provisions have been in existence for many years and they have yet to be challenged.

State legislatures, and state bank regulators will need to continue to monitor the fine line between providing seamless regulation for interstate banking companies, and the autonomy and independence that have been the hallmark of the dual banking system. Despite the opinions of some commentators that the dual banking system is without merit and results in regulatory duplication,[147] the survival of the system is not presently in doubt. Many bankers will continue to desire to work with a local regulatory presence, irrespective of the debate on the merits of other dual banking system attributes.

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147. *See generally* Butler & Macey, *supra* note 132.