

# The impact of preemption of the Georgia Fair Lending Act by the OCC on national and state banks and the dual banking system

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## Abstract

The Comptroller of the Currency (OCC) recently preempted anti-predatory lending statutes in Georgia and other states. This study investigates preemption's impact on the wealth and risk of national and state banks. Wealth increased significantly only for small, geographically diversified national banks. Preemption did not significantly reduce state bank wealth and insignificant differences in excess returns are found when similar national and state banks are compared. Small bank systematic risk rose in the post-event period but the cause is unclear. The evidence suggests that preemption did not create a significant competitive advantage for national banks endangering the dual banking system.

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## 1. Introduction

In the dual banking system in the United States commercial bankers can choose between either a national or state charter at any time. This decision determines which of the set of competing agencies supervise the bank as well as permissible activities, applicable regulations

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and supervisory costs.<sup>1</sup> The Office of the Comptroller of the Currency (OCC) supervises banks that opt for a national charter. All other banks are jointly supervised by their chartering state and either the Federal Reserve or FDIC. Charter-related differences have generally narrowed over time, but two potentially important ones remain. National banks pay higher explicit supervisory costs than state banks do, all else equal.<sup>2</sup> They also need not comply with state laws that are preempted by the OCC using statutory authority granted to the agency by the National Bank Act.<sup>3</sup> Preemption actions are controversial because they may give national banks a cost or revenue advantage relative to state chartered peers which could ultimately increase the fraction of industry assets controlled by national banks and supervised by the OCC.<sup>4</sup>

The OCC's 2003 decision to preempt the Georgia Fair Lending Act (GFLA), one of many recently enacted state anti-predatory lending laws, followed by its subsequent adoption of a final rule in 2004 preempting any state law regulating the terms of credit provided by national banks have been particularly contentious. The agency and its critics have disagreed sharply about the impact of these decisions on the performance of national and state banks. Critics of the OCC assert that these actions created a significant competitive advantage for national banks, particularly for large organizations. To buttress their claim they point to the subsequent significant increase in the share of banking assets controlled by national banks which they view as signally the demise of dual banking system.<sup>5</sup> The OCC contends that smaller national banks, especially those operating in multiple states with anti-predatory lending laws, face the heaviest compliance burden and so should be most likely to benefit from preemption.

Although most of the discussion about the effects of the OCC's recent preemption decisions has focused on potential effects on bank costs and profitability, they could influence bank risk as well. Currently, there is no empirical evidence on any of these issues and so the debate about preemption's effects on national and state banks remains unresolved.

This study investigates the effects of the OCC's recent preemption decisions on the wealth and risk of national and state banking companies using an event study approach. The impact of four related events are explored beginning with the OCC's initial announcement that it would consider preempting the GFLA in early 2003 and ending with the release of its decision that it would preempt similar state laws in early 2004. The sample consists of 131 bank holding companies that have been separated into a number of different portfolios based on their predominant charter type, size, and the geographic location of their mortgage lending activity.

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<sup>1</sup> The debate about the merits of allowing bank charter choice and competition for constituent institutions by multiple regulators in the dual banking system has been long and inconclusive. Scott (1977), Rosen (2005) and Weinberg (2002) are examples of studies investigating these issues.

<sup>2</sup> The operating revenue of the OCC comes primarily from annual assessments levied on national banks. State banks pay a supervisory fee to their home state supervisor. Neither joint federal supervisor explicitly charges state banks for supervision. The differences in supervisory costs at national and state banks and implications for the dual banking system are examined in Blair and Kushmeider (2006).

<sup>3</sup> The legal foundation for the OCC's preemption authority is presented in Office of the Comptroller of the Currency (2003a), pp. 46120–46123. Examples of recent court cases involving preemption are described in the footnotes on these pages. See also Furletti (2004), pp. 3–17 where the focus is on preemption of state restrictions on credit card issuers. For a less technical discussion see Texas Finance Commission (2006), pp. 3–8.

<sup>4</sup> Preemption has also been contentious because it has been directed at provisions of state laws intended to protect consumers. This aspect of preemption is not discussed in this paper.

<sup>5</sup> In 2004, the share of industry assets controlled by national banks rose 10 percentage points to 66.6 percent after moving within a relatively narrow range over the previous decade. This increase was basically driven by the actions of two large banking organizations.

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