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The Dodd-Frank Wall Street Reform and Consumer Protection Act: Impact on Federal Preemption for National Banks and Federal Thrifts

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I. Introduction

A. The Dodd-Frank Act: Landmark Financial Legislation

Signed into law by President Obama on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1] is landmark legislation that represents the most profound restructuring of financial regulation since the Great Depression. With the primary goal to "restore responsibility and accountability in our financial system to give Americans confidence that there is a system in place that works for and protects them," the Dodd-Frank Act will have broad impact on the financial services industry for years to come.

B. *The Dodd-Frank Act: Impact*

The Dodd-Frank Act profoundly impacts all major segments of the financial services industry, including but not limited to: 1) banks, 2) thrifts, 3) bank, financial and savings and loan holding companies, 4) mortgage businesses that include mortgage brokers, mortgage bankers and direct lenders, 5) insurance companies, 6) investment company, broker-dealer and investment advisor firms, 7) hedge funds and private equity funds, and 8) payment systems companies.

This Stay*Current* bulletin discusses the background of federal preemption and the significant impact of new preemption standards for national banks and federal thrifts, as well as their subsidiaries, under the Dodd-Frank Act.

II. Federal Preemption: Background[2]

A. *Development of the National Bank Preemption Doctrine*

With respect to national banks, preemption is the legal theory that enables them to operate nationwide, under uniform national standards, subject to the federal regulatory oversight of the Office of the Comptroller of the Currency ("OCC"). Preemption has been a key feature of the dual banking system that has developed in the U.S. since national banks were created in 1863 under the National Currency Act, which was later amended and became the National Bank Act ("NBA") – a bank regulatory structure composed of a federal system based on a national bank charter, and a state system, composed of banks chartered and supervised by state bank regulators. The dual banking system has resulted in many benefits to all banks and their customers, but preemption has become a flashpoint in the dual banking system in recent years.

Due to the interstate branching restrictions under the now repealed McFadden Act,[3] the localized culture of banking and the lack of technology that facilitates nationwide banking today, federal preemption lay dormant until the late 20th century. However, the banking world – and views on preemption – changed dramatically in the wake of the U.S. Supreme Court's 1978 decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp*.[4] In considering the applicability of the most favored lender doctrine under 12 U.S.C. § 85, the Supreme Court surprised the banking industry and regulators at that time by concluding for the first time that a national bank may charge its out-of-state credit card customers an interest rate on unpaid balances allowed by its home state, notwithstanding that the rate is impermissible under usury laws in the state of the bank's customers.[5] In responding to the petitioner's concern that permitting national banks to export interest rates under the cloak of federal law would "significantly impair" the ability of states to enact – or maintain – effective usury laws, the court responded that "[t]his impairment . . . has always been implicit in the structure of the National Bank Act" and perhaps more importantly, prophetically asserted that "the protection of state usury laws is an issue of legislative policy . . . better addressed to the wisdom of Congress than to the judgment of this Court."[6]

The *Marquette* decision caused most states in the following years to repeal their state usury laws in order to encourage the growth of the banking industry, jobs, and tax revenues in their state. Also in the wake of *Marquette*, the Depository Institutions Deregulation of Monetary Control Act of 1980 ("DIDMCA")[7] added 12 U.S.C. § 1831d, which was "designed to prevent discrimination against state chartered insured depository institutions" by seeking to level the playing field for state chartered banks in interest rate exportation issues.[8] In essence, 12 U.S.C. § 1831d was intended to mirror 12 U.S.C. § 85, giving state banks new federal authority "with respect to interest rates" to charge whatever rate allowed by the laws of the state (district or territory) where the bank was located.[9]

With the benefit of disintegrating interstate banking barriers in the ensuing years, national banks began to increasingly expand and operate across state lines. Preemption of state banking laws

provided a distinct charter advantage to national banks, and state banks operating on an interstate basis began to increasingly convert to federal banking charters. This development evoked concerns from state banks and state regulators worried about the potential decline of state banking charters. Further, consumer groups began to complain that preemption was being used as a means to help national banks evade state consumer laws.

Against this backdrop, Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act").[10] While principally concerned with the elimination of antiquated interstate branching restrictions, under the Riegle-Neal Act, national banks became subject to new standards on federal preemption. Specifically, Section 36(f) was added to the NBA to provide that an interstate branch of a national bank is generally subject to state consumer laws as if it were a branch of a state bank.[11] However, exemptions from Section 36(f) were provided to exempt national banks from state law when federal law preempts the application of such state law to the national bank,[12] or if the OCC determines that the law in question discriminates against national banks.[13] Finally, courts found that the statute provided that even when state consumer laws are not preempted, authority to enforce these state laws is vested in the OCC.[14]

As national banks continued interstate expansion after the Riegle-Neal Act, the preemption battle with the states escalated in a variety of contexts, and the U.S. Supreme Court became a primary battleground. In *Barnett Bank of Marion County, N.A. v. Nelson*, the U.S. Supreme Court held that Section 92 of the NBA, authorizing insurance agent activities in small towns for national banks, preempted Florida insurance laws that would otherwise prohibit a national bank from selling insurance in a small town.[15] In defining the preemptive scope of statutes and regulations granting powers to national banks, the Court noted that it had generally taken the view in prior cases that "Congress would not want to forbid, or impair significantly, the exercise of a power that Congress explicitly granted."[16] Accordingly, in arriving at its conclusion that preemption applied to the Florida law that prohibited insurance agencies from being affiliated with national banks, the Court set forth an important standard for determining preemption: states can only regulate a national bank where doing so "*does not prevent or significantly interfere with the national bank's exercise of its powers*."[17] (emphasis added)

After *Barnett Bank*, lower courts continued to rule in favor of preemption as state regulators continued to challenge it, and the OCC received many inquiries regarding the applicability of state law to national banks.[18]

In 2004, the OCC adopted rules consolidating both its national bank preemption and visitorial powers, the first of which primarily codified prior court decisions and OCC interpretations regarding preemption.[19] The preemption rule addressed lending, deposit taking, and other national bank activities, providing that state laws that "obstruct, impair or condition" a national bank's powers in the areas of lending, deposit taking, and other national bank operations are not applicable to national banks.[20] The rules also identified additional specific types of state laws that apply to national banks and specific types of laws that do not apply.[21]

In the second rule, the OCC clarified its visitorial powers under 12 U.S.C. § 484, which in pertinent part provides, "No national bank shall be subject to any visitorial powers except as authorized by [f]ederal law, *vested in the courts of justice* or such as shall be, or have been exercised or directed by Congress ..."[22] (emphasis added) The rule clarified the OCC's view that the scope of the OCC's exclusive visitorial authority under Section 484 applies to the content and conduct of national bank activities authorized under federal law. It also addressed areas that are not related to the business of banking, such as state unclaimed property or escheat laws.[23] Notably, the regulation also took the position that the exception for visitorial powers "vested in the courts of justice" pertains to the powers

of the judiciary and does not grant states or other government authorities rights they do not otherwise possess to examine, supervise or notably, to enforce, state laws against a national bank.[24]

It was widely felt – somewhat prematurely as it turns out – that after the adoption of the OCC preemption and visitorial powers rules, the final chapter in the preemption debate occurred as a result of the U.S. Supreme Court's 2007 decision in *Watters v. Wachovia Bank, N.A.*, where the Court rejected the efforts of the Commissioner of Michigan's Office of Insurance and Financial Services to regulate a state chartered mortgage company subsidiary of Wachovia Bank, a national bank.[25]

In its landmark decision confirming that the OCC had exclusive visitorial powers over both national banks and their operating subsidiaries, the Court held that a national bank's mortgage business – or, for that matter, any business which national banks are authorized to conduct directly – can be conducted through a state chartered operating subsidiary under the protective cloak of preemption, and is outside the licensing, reporting, and visitorial requirements of the state(s) in which the subsidiary operates.[26] A strong dissent in *Watters* noted that the sovereign power of states under the Tenth Amendment was at issue, arguing that never before "have we endorsed administrative action whose sole purpose was to pre-empt state law rather than to implement a [federal] statutory command."[27]

As the ill winds of the sub-prime lending market meltdown and the financial crisis began to blow in 2007, the *Watters* decision provoked further complaints by state authorities and consumer groups over the OCC's broad authority to exempt national banks and their state chartered subsidiaries from state regulation and consumer laws.

B. Development of the Federal Thrift Preemption Doctrine

Federal savings associations, also known as federal thrifts, are chartered under the Home Owners' Loan Act ("HOLA")[28] and are subject to the primary supervision and regulation of the soon to be abolished OTS. *See* Paul Hastings Stay*Current*—The Dodd-Frank Act: Impact on Thrifts. While analogies between national banks and federal thrifts may be drawn in preemption cases where the facts permit,[29] because each of these types of federally chartered institutions derive their powers under different statutory and regulatory schemes, analyses with respect to whether preemption applies to state laws that purport to regulate or interfere with the ability of these institutions to engage in activities granted by their federal charter must be addressed separately.[30] While thrift preemption cases may not have engendered as much national attention as the U.S. Supreme Court preemption cases involving national banks discussed in this article, there is a fairly well-developed body of case law involving thrift preemptions based on OTS regulations that have been described by courts as "incredibly broad and govern the operations of every federal savings and loan association."[31]

Over the years, the OTS has promulgated several regulations that address preemption. Similar to the broad preemptive authority asserted by the OCC in its regulations that implement the NBA with regard to state laws, the OTS's general preemption regulation states "[t]his exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a [f]ederal savings association."[32] With respect to lending and investment activities of federal savings associations, the OTS has asserted that it "hereby occupies the entire field of lending regulation for federal savings associations," and has set forth the following test with respect to analyses under 12 C.F.R. § 560.2:

> [T]he first step will be to determine whether the type of law in question is listed in paragraph (b). If so, the analysis will end there; the law is preempted. If the law is not covered by paragraph (b), the next question is whether the law affects lending. If it does, then, in accordance with paragraph (a), the presumption arises that the law is preempted. This presumption can be reversed only if the law can clearly be shown to

> fit within the confines of paragraph (c). For these purposes, paragraph (c) is intended to be interpreted narrowly. Any doubt should be resolved in favor of preemption.[33]

Applying the analytic framework set forth by the OTS with respect to analyses under 12 C.F.R. § 560.2, the Ninth Circuit determined in *Silvas v. E*Trade Mortgage Corp.* that the HOLA and OTS regulations preempted a California law that purported to require E*Trade Mortgage Corporation, a subsidiary of a federal thrift, to refund mortgage "lock-in fees" to mortgage applicants after the applicants cancelled a transaction within the three-day window permitted by federal law.[34] In its analysis, the court asked whether each of the state laws at issue, as applied, was the "type of state law contemplated in the list under paragraph (b)" of 12 C.F.R. § 560.2.[35] With respect to the first claim asserting unfair advertising under state law, the court determined that because the claim was "entirely based on E*Trade's disclosures and advertising, it falls within the specific type of law listed in § 560.2(b)(9). Therefore, the preemption analysis ends."[36] Having found that the specific state laws at issue were covered by paragraph (b) – and were thus preempted and resolved under the first step of the preemption test – the court declined to address whether the appellants' claims also fell within the type of state laws not typically preempted under paragraph (c).[37] Specifically, the court noted "[w]e do not reach the question of whether the law fits within the confines of paragraph (c) because Appellants' claims are based on types of laws listed in paragraph (b) of § 560.2. . . ."[38] Accordingly, in applying the analytic framework of 12 C.F.R. § 560.2, *Silvas* and other cases as well as OTS opinion letters demonstrate the mechanical nature of analyses under the law, as applied to state laws that purport to regulate or interfere with the activities of federal savings associations.[39]

In *State Farm Bank v. Reardon*, the Sixth Circuit reversed a lower court's determination that exclusive insurance agents acting as mortgage brokers on behalf of State Farm Bank, a federal thrift, were required to comply with licensing and registration requirements under state law based on the district court's interpretation that existing federal law did not preempt the application of state law to such third parties.[40] The Sixth Circuit's reversal was based on what the court noted was an improper distinction made by the district court "between state regulation of a federal savings association, its employees, and subsidiaries who engage in lending and banking activities on behalf of an association and state regulation of exclusive agents who engage in the same conduct on behalf of an association."[41]

Applying the principles set forth in *Watters*, the Sixth Circuit in *Reardon* noted that "properly understood, *Watters* stands for the proposition that when considering whether a state law is preempted by federal banking law, the courts should focus on whether the state law is regulating the exercise of a national bank's power, not on whether the entity exercising that power is the bank itself."[42] Foreseeing the impracticability that would result with respect to a federal savings association's operations if it were forced to be subject to a patchwork of regulation in every state it wishes to operate – a key argument in the preemption debate – the Sixth Circuit accordingly found that the OTS's regulations preempted state law as it applied to the activities of State Farm Bank's exclusive agents.[43] In arriving at its conclusion, the court reasoned that "[b]y requiring State Farm Bank's exclusive agents to satisfy the Ohio Act's fairly onerous licensing and registration requirements, Ohio is 'purporting to regulate or otherwise affect [the] credit activities' of State Farm Bank."[44]

Therefore, under *Reardon*, state laws were preempted to the extent that they purport to regulate or interfere with the exercise of a federal savings association's permitted lending powers by regulating the activities of independent third parties who act as exclusive agents on behalf of the thrift.

III. The U.S. Supreme Court's Decision in the *Cuomo* Case

As the preemption debate escalated in 2008 and 2009 amid allegations of mortgage and credit card lending abuses during the financial boom, national banks and the OCC received a significant and, by

all accounts, unexpected surprise on the preemption issue from an unlikely source: the U.S. Supreme Court. In *Cuomo v. Clearing House Association, L.L.C.*, the Court revisited the preemption issue as it applied to the New York state attorney general, who sought certain non-public information "in lieu of [a] subpoena" from national banks to determine whether they had violated New York's fair lending laws.[45] In the courts below, the District Court enjoined the attorney general from enforcing state fair lending laws through demands for records or judicial proceedings, and the Second Circuit affirmed, citing the preemptive effect of the NBA and OCC regulations.[46] In revisiting the preemption debate with respect to *Cuomo*, the Court reversed its long standing judicial support for the preemption doctrine in the context of the OCC's visitorial powers, ruling that state attorneys general are not preempted by federal banking laws from bringing lawsuits against national banks for violations of state fair lending and consumer laws.[47]

Cuomo was the first U.S. Supreme Court case involving issues of NBA federal preemption since *Watters*. As settled in *Watters*, the Court recognized that the NBA grants the OCC, as part of its supervisory authority, visitorial powers to audit the books and records of national banks and their operating subsidiaries, largely to the exclusion of other state or federal entities.[48] However, in revisiting the "visitorial powers" issue again, *Cuomo* raised a different issue – whether the OCC's regulation intending to preempt state law enforcement can be upheld as a reasonable interpretation of the NBA.[49] The Court noted that the OCC reasonably interpreted the NBA's "visitorial powers" term to include "conducting examinations [and] inspecting or requiring the production of books or records of national banks," when the state conducts those activities as supervisor of corporations.[50] However, the Court made the distinction that when:

> a state attorney general brings suit to enforce state law against a national bank, he is not acting in the role of sovereign-as-supervisor, but rather sovereign-as-law-enforcer. Because such a lawsuit is not an exercise of "visitorial powers," the Comptroller erred by extending that term to include "prosecuting enforcement actions" in state courts.[51]

Specifically, in finding that there was some ambiguity in the NBA's term "visitorial powers" under 12 U.S.C. § 484(a), the Court partially invalidated the OCC's visitorial powers rule – concluding that while the OCC regulation was a reasonable interpretation of the NBA to the extent that it referred to a state sovereign's supervisory power over national banks, or lack thereof, the OCC's interpretation of its exclusive visitorial powers to include prosecuting enforcement actions was not a reasonable interpretation of Section 484.[52] Accordingly, the Court in *Cuomo* made clear that the NBA does not prohibit ordinary enforcement of state law.[53]

In clarifying that the term "visitorial powers," as used in Section 484 of the NBA, only referred to the OCC's exclusive authority to examine and supervise national banks, as opposed to the authority of the states to investigate and enforce state laws against national banks, the Court's decision dramatically impacted the ongoing preemption debate in favor of the states.[54] For one thing, the *Cuomo* decision clarified that a distinction exists between a sovereign state's visitorial powers and its enforcement power, and that only visitorial powers are preempted, i.e., states are permitted to enforce their own laws that "are not contrary to, or expressly preempted by, federal law."[55]

The Obama administration, with the timely rationale of codifying the *Cuomo* decision, lost no time reacting to the *Cuomo* decision, with the U.S. Department of the Treasury introducing legislation the very next day to accomplish the administration's goal of establishing a Consumer Financial Protection Agency ("CFPA"), a new federal consumer watchdog agency that would function to, among other things, enhance the ability of the states to enforce consumer laws against federally chartered banks and establish new federal consumer financial rules applicable to a broad range of financial

institutions.[56] In the ensuing months, both the Senate and House of Representatives in Congress introduced their own proposals for financial regulatory reform that included the establishment of the CFPA, or a variation thereof, which later became known as the Bureau of Consumer Financial Protection ("BCFP").[57]

IV. The Dodd-Frank Act: Preemption Provisions

Title X of the Dodd-Frank Act is entitled the "Consumer Financial Protection Act of 2010" (the "Act"). Subtitle D of Title X addresses the applicability of state consumer financial laws to federally chartered institutions and their subsidiaries, affiliates and agents. A "state consumer financial law" is defined as "a [s]tate law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer." Absent a preemption determination, the potential universe of applicable state consumer financial laws could be quite large, and may include state licensing and registration laws, fair lending laws, as well as laws defining and/or prohibiting unfair, deceptive or abusive practices.[58] Given that applicability of the preemption provisions of the Dodd-Frank Act hinges on whether a state law at issue meets the definition of a "state consumer financial law," we believe that this definition will be subject to interpretation and thus further guidance from the courts and/or through agency rulemaking.

A. New Limits on Federal Preemption for National Banks and Federal Thrifts

Section 1044 of Title X sets forth new preemption standards for national banks that will have far reaching implications. Specifically, rather than being able to draw from the range of U.S. Supreme Court precedent finding that state laws do not apply to national banks where they impermissibly impair or otherwise restrict a bank's exercise of a federally authorized power,[59] under the preemption standard prescribed by the Act, preemption of a state consumer financial law is permissible only if: (1) application of the state law would have a discriminatory effect on national banks as compared to state banks; (2) the state law is preempted under the standard articulated in *Barnett Bank* (see discussion of the case in Section II.A above), with such preemption determination being made either by the OCC (by regulation or order) or by a court, in either case on a "case-by-case" basis; or (3) the state law is preempted by another provision of federal law other than the Act.

Section 1044 also specifies that, with respect to preemption determinations made by the OCC on a case-by-case basis by regulation or order, such determination must be limited to a particular state law, as it impacts any national bank that is subject to that law, or the law of any other state with "substantively equivalent" terms. The OCC is required to consult with the BCFP on any determination regarding whether a state law is "substantively equivalent" to a law that is the subject of an OCC preemption determination. In addition, OCC preemption determinations made based on the *Barnett Bank* standard would not be valid unless the record supporting the determination includes "substantial evidence" that preemption is consistent with that standard.

It remains to be seen how the courts and the OCC, in consultation with the BCFP, will interpret and utilize the clause "or the law of any other state with substantively equivalent terms" as the basis for preempting a state law, based on another state's law which the OCC is preempting or has preempted.

The OCC must also conduct periodic reviews (at least once every five years), through notice and public comment, of its preemption determinations and upon concluding a review, must announce its decision on whether to continue or rescind the determination or issue a proposal to amend the determination. It is unclear whether this requirement for periodic reviews will create business

uncertainty for a national bank or federal thrift relying on a preemption determination, with respect to whether such determination will be continued, rescinded or amended every five years.

Notably, the Comptroller of the Currency is explicitly prohibited from delegating to the OCC staff any preemption determinations.

B. New Judicial Standards for Reviewing OCC Preemption Decisions

Section 1044 also defines the standard of review that a court must use when reviewing an OCC preemption determination. Although the *Chevron* deference standard[60] appears to have been preserved in a savings clause, Section 1044 provides that a court reviewing any preemption determinations of the OCC would be required to "assess the validity of such determinations, depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency of other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision." In particular, with respect to preemption determinations made by the OCC under the *Barnett Bank* standard, the OCC may not preempt a state consumer financial law unless "substantial evidence," made on the record of the proceeding, supports the specific finding that the state law "prevents or significantly interferes with the exercise by the national bank of its powers."

C. Repeal of Watters – State Consumer Laws Applicable to Non-Depository Institution Subsidiaries

Section 1044 of the Act provides that state consumer financial laws shall not be preempted by the Act (or by Section 24 of the Federal Reserve Act ("FRA"),[61] which permits national banks to make real estate-secured loans) with respect to subsidiaries and affiliates of national banks that are not themselves national banks – overruling the U.S. Supreme Court decision in *Watters* (discussed above in Section II.A). That is, the Act specifies that state consumer financial laws shall apply to a subsidiary <u>or</u> affiliate of a national bank (other than a national bank that is a subsidiary or affiliate) to the same extent that the state consumer financial law applies to any person, corporation or entity subject to such state law. Section 1045 further amends the NBA to specify that neither the NBA nor Section 24 of the FRA may be construed as preempting, annulling or otherwise affecting the application of any state law to any subsidiary, affiliate or agent of a national bank, other than one that is a national bank. Interestingly, the additional category of "agent" was added to Section 1045, which was intended to clarify in the NBA that preemption no longer applies to non-bank entities (i.e., a "subsidiary, affiliate, or agent" of a national bank that is not chartered as a national bank); however the term "agent" was not included in Section 1044, which is the operative provision that provides that state consumer financial laws specifically apply to such entities.

The preemption provisions contained in Subtitle D of the Act, including the provision that repeals the availability of preemption for operating subsidiaries of national banks and federal thrifts, become effective on the "designated transfer date" which, as determined by the Secretary of the Treasury (in consultation with other agencies) is July 21, 2011.[62]

An area of concern with respect to the impact of the Act's repeal of preemption for operating subsidiaries of national banks and federal thrifts is whether such change in law would affect the eligibility of mortgage loan originators who are employees of an operating subsidiary of a national bank or federal thrift in qualifying for federal registration under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "S.A.F.E. Act").[63] The S.A.F.E. Act requires all residential mortgage loan originators to be either state licensed or federally registered with a nationwide registry, obtain a unique identifier, and maintain this registration.[64] Federal registration is valid for national coverage while employees subject to state licensing requirements must submit to the state-by-state

licensing regime based on the state(s) in which the employee operates. The S.A.F.E. Act treats employees of depository institution subsidiaries the same as employees of the depository institution, if the subsidiary is "owned and controlled by the depository institution" *and* "regulated by a Federal banking agency."[65] While the Dodd-Frank Act amends the S.A.F.E. Act to transfer the responsibilities of the Federal banking agencies, with respect to developing and maintaining the system for registering employees of Federal banking agencies, to the BCFP (to become effective on the designated transfer date), the amendments do not otherwise alter the requirements for loan originators in qualifying for federal registration.[66] Therefore, employees of operating subsidiaries of depository institutions including national banks and federal thrifts would still continue to qualify for federal registration pursuant to the statutory criteria. However, because the Act provides that preemption of state consumer financial laws is no longer available for operating subsidiaries of national banks and federal thrifts, we note that it is possible for a federally registered loan originator who is an employee of an operating subsidiary of a national bank or federal thrift to nevertheless be required to comply with state licensing and registration requirements under the S.A.F.E. Act, in addition to his or her federal registration. Whether a federally registered mortgage loan originator employed by an operating subsidiary of a national bank or federal thrift will be required to comply with state licensing and registration requirements will likely depend on applicable state law and a potential determination by the BCFP to avoid duplicative federal/state registration requirements.[67] For additional discussion on the impact of the Dodd-Frank Act on mortgage businesses, *see* Paul Hastings Stay*Current*—The Dodd-Frank Act: Impact on Mortgage Businesses.

It is important to note that Section 1044 specifies that Title X does not affect the authority of national banks to export their home state interest rate under the "most favored lender" doctrine of 12 U.S.C. § 85.

D. Codification of Cuomo – OCC Visitorial Authority

Section 1047 of the Act amends the NBA to specify that, in accordance with the U.S. Supreme Court's 2009 decision in *Cuomo v. Clearing House Association, L.L.C.*,[68] the visitorial powers provisions of the federal banking laws should not be construed to limit the authority of state attorneys general to bring actions in court against a national bank to enforce "an applicable law and to seek relief as authorized by such law." Significantly, Section 1047(j) also provides that the ability of the OCC to bring an enforcement action regarding consumer law matters does not preclude a private right of action to enforce rights granted under federal or state law.

E. Federal Thrifts

Sections 1046(a) and 1047(b), respectively, amend Section 6 of the HOLA to apply the new national bank preemption and visitorial standards to federal savings associations. Significantly, in addition to conforming the preemption standards for national banks to federal thrifts under the HOLA, Section 1046 of the Act also amends the HOLA to explicitly provide that the HOLA "does not occupy the field in any area of [s]tate law." Suffice to say, this provision eliminates the long standing field preemption that the OTS has asserted over thrift deposit taking and lending activities, and substantially reduces the scope of federal preemption available to the thrift industry under prior law.

F. State Law Preemption

Section 1041 of the Act provides that the Act does not preempt state law except in cases where state law is "inconsistent" with the Act. In particular, Section 1041 clarifies that a state law that affords consumers greater protection than provided by the Act is not "inconsistent" with the Act. The Act also authorizes state attorneys general, following consultation with the BCFP, to bring civil actions "in the name of [their] state" to enforce the Act or regulations issued thereunder against state banks, although the ability of state attorneys general to bring civil actions in the name of a state to enforce

provisions of the Act against national banks and federal savings associations is restricted. Specifically, state attorneys general would not be permitted to bring civil actions against national banks and federal savings associations for violations of the Act, but they would be authorized to bring such actions to enforce any regulations prescribed by the BCFP under the Act. Based on the codification of *Cuomo* (see Section IV.D above), this restriction does not appear to affect the innate powers of state attorneys general to enforce applicable state laws against federally chartered institutions.

V. Title X of the Dodd-Frank Act: Action Plan

National banks and federal thrifts relying on federal preemption with respect to their current or planned interstate activities will be well-served to have an action plan in response to the preemption-related provisions of Title X of the Dodd-Frank Act. We recommend that this action plan include the following considerations:

- Understand how the *Barnett Bank* preemption standard will impact the application of state consumer and unfair or deceptive acts and practices laws (collectively, "state consumer laws") to your bank's activities in all states in which you currently operate or plan to operate.

- Monitor the OCC's required adoption of new rules implementing the Dodd-Frank Act preemption provisions—these new rules will profoundly impact the extent to which state consumer laws will be applicable to the activities of national banks and federal thrifts.

    - Be pro-active in considering whether to seek favorable interpretive rulings from the OCC under the new rules on preemption of state consumer laws, which may only be granted by the OCC on a case-by-case basis.

- Prepare for the likelihood that state attorneys general will seek to enforce state consumer laws—you will need to undertake a survey of applicable state consumer laws and assess potential compliance issues.

    - Understand how the codification of the *Cuomo* case affects your bank, particularly with respect to the need for understanding the types of state consumer laws that may be enforced by each state.

- Prepare for the likelihood of significantly increased consumer litigation, particularly involving the BCFP, state attorneys general and class action plaintiffs. Assemble a multi-disciplinary team now to tackle the complex web of regulatory, litigation and government investigation issues that are likely to arise in connection with such litigation.

- If you have a mortgage lending subsidiary, consider the impact of the Dodd-Frank Act's invalidation of the *Watters* decision, and assess the relative merits of merging the lending operations of the operating subsidiary into the parent bank.

    - Your decision should involve an assessment of the relative merits of being able to rely on federal preemption in the post-Dodd-Frank Act era versus the potential legal risk of not conducting such activities through a separately incorporated entity.

    - If the decision is to continue mortgage lending operations through an operating subsidiary, as of July 21, 2011 (or any extension of the designated transfer date), you will be required to comply with the applicable mortgage licensing and lending laws of each state in which an operating subsidiary operates. You will need to undertake a state survey of state licensing and lending laws, and begin to prepare required filings, notices and compliance programs.

To view other thought leadership pieces on how this landmark legislation and the myriads of implementing regulations will affect your industry, please follow this link.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] Much of the preemption background discussion and analysis in this Stay*Current* bulletin is taken from V. Gerard Comizio and Helen Y. Lee, *Understanding the Federal Preemption Debate and a Potential Uniformity Solution,* 6 Am. U. Bus. L. Brief 51 (Spring/Summer 2010). V. Gerard Comizio is the Chair of the Global Banking Group and Helen Y. Lee is an associate in the Group.

[3] McFadden Act of 1927, Pub. L. No. 69-639, 44 Stat. 1224,1228-29 (1927) (giving individual states the authority to govern bank branches located within the state).

[4] *Marquette Nat'l Bank v. First of Omaha Svc. Corp.*, 439 U.S. 299 (1978).

[5] *See id*. at 314-315.

[6] *Id*. at 319.

[7] Depository Institutions Deregulation of Monetary Control Act of 1980, Pub. L. No. 96-221, § 521, 94 Stat. 132 (1980) (adding 12 U.S.C. § 1831d(a)).

[8] 12 U.S.C. § 1831d(a).

[9] *See id*. (providing that a bank may charge no more than one percent in excess of the federal interest rate or the maximum permissible rate where the bank is located).

[10] Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (1994).

[11] 12 U.S.C. § 36(f) (providing law applicable to interstate branching operations).

[12] *Id*. § 36(f)(1)(A)(i).

[13] *Id*. § 36(f)(1)(A)(ii); *see also* 12 U.S.C. § 43 (1994) (with respect to interpretations concerning preemption of certain state laws).

[14] 12 U.S.C. § 36(f)(1)(B) (stating that "[t]he provisions of any State law to which a branch of a national bank is subject under this paragraph shall be enforced, with respect to such branch, by the Comptroller of the Currency.").

[15] *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 32 (1996) (noting that language in § 92 that permits national banks to act as an agent for insurance sales "suggests a broad, not a limited, permission."); *see also* 12 U.S.C. § 92.

[16] *Barnett Bank*, 517 U.S. at 33.

[17] *Id*.

[18] *See, e.g.*, *Am. Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000, 1017-1018 (E.D. Cal. 2002) (applying the *Barnett Bank* standard and deferring to OCC interpretation regarding whether a California consumer law constituted a significant interference with national banks' powers under the NBA); *see also Ass'n of Banks in Ins., Inc. v. Duryee*, 55 F. Supp. 2d 799, 812 (S.D. Ohio 1999) (granting motion for summary judgment to plaintiff holding that certain provisions of the Ohio Revised Code dealing with licensing of insurance agents in Ohio are preempted under 12 U.S.C. § 92).

[19] 69 Fed. Reg. 1916 (Jan. 13, 2004); 69 Fed. Reg. 1895 (Jan. 13, 2004).

[20] *See* 12 C.F.R. Parts 7 and 34.

[21] 12 C.F.R. §§ 7.4008-4009 and 34.4.

[22] 12 C.F.R. § 7.4000.

[23] 12 C.F.R. § 7.4000(b)(1)(ii).

[24] 12 C.F.R. § 7.4000(b)(2).

[25] *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 21-22 (2007) (holding that although the laws of the States in which national banks or their subsidiaries are located govern matters the NBA does not address, state regulators cannot interfere with the "business of banking" by subjecting national banks or their OCC-licensed operating subsidiaries under rival oversight regimes).

[26] *Id*. at 18-21 (observing that the Court had "never held that the preemptive reach of the [National Bank Act] extends only to a national bank itself," the Court determined that "[s]ecurity against significant interference by state regulators is a characteristic condition of the 'business of banking' conducted by national banks, and mortgage lending is one aspect of that business.").

[27] *Id*. at 44 (Stevens, J., Roberts, C.J. and Scalia, J., dissenting).

[28] 12 U.S.C. §§ 1461 *et seq*.

[29] *See, e.g., State Farm Bank v. Reardon*, 539 F.3d 336, 344-46 (6th Cir. 2008) (discussing thrift preemption principles from *Watters*); *see also Jefferson v. Chase Home Finance*, 2008 WL 1883484 at *9 (N.D.Cal.) (*citing Silvas v. E*Trade Mortgage Corp.*, 421 F. Supp. 2d 1315, 1319 (S.D. Cal. 2006), which found analogous regulations under the parallel regulation under HOLA expressly preempt laws in enumerated categories).

[30] *See, e.g., SPGGC, LLC et. al. v. Ayotte*, 488 F.3d 525, 531 (1st Cir. 2007), cert. denied 128 S. Ct. 1258 (2008) (stating that, "because [national bank's] and [federal thrift's] activities are regulated under different statutory schemes, we address their preemption claims separately.").

[31] *Silvas v. E*Trade Mortgage Corp.*, 421 F. Supp. 2d 1315, 1318-1319 (S.D. Cal. 2006) (*citing Bank of America v. City and County of San Francisco*, 309 F.3d 551, 558 (9th Cir. 2002)). For a discussion of the conflict between federal preemption and state unfair or deceptive acts or practices laws in the context of the jurisdiction of the OTS, *see* V. Gerard Comizio & Kevin Petrasic, *Data Breach, UDAPs and the Federal Thrift Charter: States' Rights And Federal Prerogatives*, Privacy & Data Security L. J. 765 (Sept. 2008).

[32] 12 C.F.R. § 545.2.

[33] 12 C.F.R. § 560.2. 61 Fed. Reg. 50951, 50966-50967 (Sept. 30, 1996). *See Silvas v. E*Trade Mortgage Corp.*, 514 F.3d 1001, 1005 (9th Cir. 2008) (applying the analytic framework of 12 C.F.R. § 560.2).

[34] *Id*. at 1008.

[35] *Id*. at 1005.

[36] *Id*. at 1006 (the court also analyzed a second claim alleging that the lock-in fee itself was unlawful, which the court found was addressed by a separate provision of paragraph (b), specifically 12 C.F.R. § 560.2(b)(5), which specifically preempts state laws purporting to impose requirements on loan related fees).

[37] *See id.* at 1006-07.

[38] *Id*. at 1006 (referring specifically to (b)(9) and (b)(5)).

[39] *See, e.g., Amaral v. Wachovia Mortgage Corp.*, 2010 WL 618282, at *10-11 (E.D. Cal.); *see also Alcaraz v. Wachovia*

Mortgage FSB, 592 F. Supp. 2d 1296, 1305 (E.D. Cal. 2009); *see also Kajitani v. Downey Sav. & Loan Ass'n, F.A.*, 647 F. Supp. 2d 1208, 1218 (D. Haw. 2008); *see also Crespo v. WFS Financial Inc.*, 580 F. Supp. 2d 614, 621-622 (N.D. Ohio 2008) (noting that "where a law is found to fall under 560.2(b), which lists examples of the types of laws preempted by 560.2(a), it is expressly preempted and the preemption analysis ends. As discussed below, the court finds that the state laws at issue here are expressly preempted by 560.2(b). Therefore, because this ends the preemption analysis, Plaintiffs' claims cannot be saved from preemption through a finding that the state laws do not affect lending or that they fall under section (c)."). *See also* OTS Op. Chief Counsel, 7 (Dec. 24, 1996), *available at* http://files. ots.treas.gov/56615.pdf (applying the analytic framework of 12 C.F.R. § 560.2 to decide whether federal law preempts Indiana consumer credit laws under § 560.2(b)(9)).

[40] *Reardon*, 539 F.3d at 338; *see also State Farm Bank, F.S.B. v. Burke*, 445 F. Supp. 2d 207, 219-220 (D. Conn. 2006) and *State Farm Bank, F.S.B. v. District of Columbia*, 640 F. Supp. 2d 17, 19-20 (D. D.C. 2009) (the State Farm Bank cases arose out of the same set of facts involving a 2004 preemption opinion letter from the OTS regarding State Farm Bank's use of independent and exclusive agents to conduct its operations. The OTS opinion letter found that state regulation over State Farm Bank's marketing agents was preempted and reasoned that the HOLA and accompanying regulations dominated the field to the exclusion of state regulations.).

[41] *Reardon*, 539 F.3d at 342.

[42] *Id*. at 345 (*referencing Watters*, 550 U.S. at 16-18).

[43] *Id*. at 347 (*citing* 12 C.F.R. § 560.2(a)).

[44] *Id*.

[45] *Cuomo v. Clearing House Association, L.L.C.*, 129 S. Ct. 2710, 2712 (2009). Notably, the *Cuomo* court majority included Justices Scalia (who wrote the opinion for the majority) and Stevens, who were part of the dissent in the *Watters* case.

[46] *Id*.

[47] *See id*. at 2721 (explaining that the NBA's provision that limits a State's "visitorial powers" over national banks, applies only to a sovereign's power to supervise corporations, but not to a state attorney general's efforts to enforce state laws against a national bank).

[48] *See id*. at 2717 (referencing the holding in *Watters*, that a State may not exercise "general supervision and control" over a subsidiary of a national bank because "multiple audits and surveillance under rival oversight regimes" would cause uncertainty).

[49] *Id*. at 2714-15.

[50] *Id*. at 2721 (referencing the visitorial powers rule explained in 12 C.F.R. § 7.4000(a)).

[51] *Cuomo*, 129 S. Ct. at 2721.

[52] *Id*. at 2722.

[53] *Id*. at 2715.

[54] *See* Barkley Clark & Barbara Clark, Public Litigation Preemption: Lower Courts Begin to Respond to Supreme Court's Cuomo Decision, 01-10 Clark's Sec. Trans. Monthly 4 (Jan. 2010) (noting that "[i]n limiting the term 'visitorial powers' found in the NBA, the High Court greatly expanded the power of state attorneys general to issue subpoenas and file suits against national banks for violation of state statutes such as fair lending laws.").

[55] *See* Shannon P. Duffy, Pa., N.J. Federal Courts Greenlight Class Actions Over Gift Card Fees, The Legal Intelligence (Nov. 19, 2009); *see also Mwantembe v. TD Bank*, 669 F. Supp. 2d 545, 549 (E.D. Pa. 2009). Technically, the *Cuomo* decision did not apply to federal thrifts, as its holding was limited to national banks in interpreting the NBA. However, it certainly could raise similar issues for federal thrifts in a judicial context.

[56] *See generally* U.S. Dept. of the Treasury, Financial Regulatory Reform: A New Foundation, *available at* http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

[57] *See, e.g.*, S. 3217, the "Restoring American Financial Stability Act of 2010," reported out by the Senate Committee on Banking, Housing and Urban Affairs on March 22, 1010. Among other things, the bill proposed a new Consumer Financial Protection Bureau that would be housed in the Federal Reserve but would not report to the Federal Reserve. On May 20, 2010, H.R.4173, prior to which was known as the "Wall Street Reform and Consumer Protection Act of 2009" was passed by the Senate in lieu of S. 3217 with an amendment and an amendment to the title to be known as the "Restoring American Financial Stability Act of 2010." On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[58] For example, the list of "enumerated consumer laws" that will be within the BCFP's purview includes, among others, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the S.A.F.E. Mortgage Licensing Act, the Truth in Lending Act, and the Truth in Savings Act. *See* Section 1002(12) of the Dodd-Frank Act.

[59] *See* Special Interest – On Preemption and Visitorial Powers 27 (Mar. 2004), 23 OCC Q.J. 1, 43, *available at* http://www.occ.gov/qj/qj23-1/3-SpecialInterest.pdf [hereinafter "Special Interest"] (noting that "[t]he variety of formulations quoted by the Court—"unlawfully encroach," "hamper," "interfere with or impair national banks' efficiency"—defeats any suggestion that any one phrase constitutes the exclusive standard for preemption").

[60] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[61] 12 U.S.C. § 371.

[62] 75 Fed. Reg. 57252 (Sept. 20, 2010). As prescribed in Section 1062 of the Dodd-Frank Act, the "designated transfer date" will not be earlier than 180 days but generally no more than 12 months after enactment of the Dodd-Frank Act, and may be extended up to an additional 6 months past the 12 month general deadline if the Treasury Secretary provides to the "appropriate committees of Congress" certain documentation including a written determination that the 12 month deadline is not feasible for an orderly implementation of the transfer of consumer financial protection functions of the various agencies to the BCFP and an explanation for why an extension is necessary.

[63] 12 U.S.C. §§ 5101 *et seq*.

[64] 12 U.S.C. § 5103.

[65] 12 U.S.C. § 5102(7). *See* page 13 of draft final rule, as approved by the FDIC on November 12, 2009, *available at* http://www.fdic.gov/news/board/2009nov12no8.pdf.

[66] *See* Section 1100 of the Dodd-Frank Act.

[67] For example, for states that have adopted without modification the Model State Law as proposed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, an exemption from state licensing requirements is provided for "registered mortgage loan originators." This category of persons exempted from the licensing and registration requirements of the state law encompasses mortgage loan originators who are employees of depository institutions and their operating subsidiaries who are already registered with and maintain a unique identifier through the Nationwide Mortgage Licensing System and Registry. Given that the preemption provisions of the Dodd-Frank Act apply only to the "subsidiaries and affiliates" of national banks and federal thrifts, rather than the subsidiaries of other types of depository institutions, *e.g.*, state chartered banks, the application of a state law that implements the S.A.F.E. Act to a mortgage loan originator who is an employee of an operating subsidiary of a national bank or federal thrift would likely have a discriminatory impact on national banks and thrifts, as employees of subsidiaries of state chartered depository institutions may continue to be subject only to the federal registration requirements as implemented by the Agencies. *See* page 10, fn. 12 of draft final rule, as approved by the FDIC on November 12, 2009, *available at* http://www.fdic.gov/news/board/2009nov12no8.pdf (noting that employees of depository institutions and their subsidiaries "acting within the scope of their employment are subject only to the Federal registration requirements of the S.A.F.E. Act as implemented by the Agencies through this rulemaking.").

[68] Cuomo v. Clearing House Association, L.L.C., 129 S.Ct. 2710 (2009).