

Wall Street Reform and Consumer Financial Protection Act of 2010

Federal Preemption

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Presented By Oliver Ireland and Joseph Gabai

Financial Reform Legislation

- Dodd-Frank Wall Street Reform and Consumer Protection Act
- Timeline
 - President's White Paper - May 2009
 - Passed by the House – December 11, 2009
 - Passed by the Senate – May 20, 2010
 - Conference Report – June 29, 2010
 - Passed by the House – June 30, 2010
 - Passed by the Senate – July 15, 2010
 - Signed by the President – July 21, 2010
- Public Law No. 111-203
- 16 Titles, 2300 pages

Introduction

Subtitle D of Title X of the Dodd-Frank Act – the Consumer Financial Protection Act of 2010 (“CFPA”)

- Section 1041. Relation to state law.
- Section 1042. Preservation of enforcement powers of states.
- Section 1043. Preservation of existing contracts.
- Section 1044. State law preemption standards for national banks and subsidiaries clarified.
- Section 1045. Clarification of law applicable to non-depository institution subsidiaries.
- Section 1046. State law preemption standards for federal savings associations and subsidiaries clarified.
- Section 1047. Visitorial standards for national banks and savings associations.
- Section 1048. Effective date.

Overview

- This legislation is a “game-changer” for the federal preemption doctrine. It creates new statutory frameworks for –
 - Conflicts between the CFPA and state law
 - Conflicts between the “Enumerated Consumer Laws” and state law
 - Conflicts between OCC regulations/orders and state consumer financial laws
- New rules for state attorneys general actions under the CFPA and state law, including against national banks
- Elimination of National Bank Act (NBA) federal preemption rights for national bank operating subsidiaries
- A narrowing of the OCC’s visitorial powers
- Limited grandfathering of existing contracts
- For national bank preemption, much will depend on the willingness of the new Comptroller to issue preemptive regulations under the new statutory regime

The Bureau

- The Consumer Financial Protection Bureau (Bureau) is an independent bureau within the Federal Reserve System
- The Bureau has the power to write consumer protection rules governing all financial institutions that offer consumer financial products or services
- Rulemaking authority under certain consumer protection laws shifted from existing agencies to the Bureau
- Bureau is authorized to examine and enforce these rules for depository institutions with more than \$10B of assets, mortgage-related businesses, and larger participants in the market for non-mortgage consumer financial services
- Depositories with \$10B or less in assets will continue to be examined by their existing regulators, but Bureau may examine those institutions “on a sampling basis of the examinations performed by the prudential regulator”

Federal – State Law Conflicts

Dodd-Frank Act addresses three types of federal – state law conflicts

- Conflicts between the CFPB and state laws, regulations, orders or interpretations (CFPB Conflicts)
- Conflicts between the Enumerated Consumer Laws and any state laws (Enumerated Consumer Law Conflicts)
- Conflicts between state consumer financial laws and laws applicable to national banks and federal savings associations (Charter Conflicts)

CFPA Conflicts

- Basic Rule – State statute, regulation, order or interpretation is preempted by the CFPA only if the state law is “inconsistent with the CFPA . . . and then only to the extent of the inconsistency”
- State law is not inconsistent if it provides greater protection than the CFPA
- Example: State laws requiring that contracts be translated into more foreign languages than required by a future CFPA regulation
- Bureau authorized to determine if the state law is inconsistent with the CFPA, either on its own motion or in response to a nonfrivolous petition by an interested person
- CFPA Conflicts do not include the Enumerated Consumer Law Conflicts or Charter Conflicts discussed below. They also do not include conflicts with laws that are outside of the CFPA (e.g., laws governing capital requirements)

Enumerated Consumer Law Conflicts

- Basic Rule – Federal preemption issue is resolved solely by the standards set forth in each of the Enumerated Consumer Laws
- Those standards vary considerably. Many, but not all, of them preempt state laws that are inconsistent with federal law, and they do not treat more protective state laws as inconsistent
- Enumerated Consumer Laws are listed in §1002(12) of Dodd-Frank, and cover the most important federal consumer financial protection statutes
 - Alternative Mortgage Transaction Parity Act of 1982
 - Consumer Leasing Act of 1976
 - Electronic Fund Transfer Act
 - Equal Credit Opportunity Act
 - Fair Credit Billing Act
 - Fair Credit Reporting Act (FCRA)
 - Homeowners Protection Act of 1998

Enumerated Consumer Laws (cont'd)

- Fair Debt Collection Practices Act
- §43(b)-(f) of the Federal Deposit Insurance Act (FDIA) – governing disclosures by depository institutions that lack federal deposit insurance
- Gramm-Leach-Bliley Act (GLBA)
- Home Mortgage Disclosure Act of 1975
- Home Ownership and Equity Protection Act of 1994
- Real Estate Settlement Procedures Act of 1974
- Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)
- Truth in Lending Act
- Truth in Savings Act
- §626 of the Omnibus Appropriations Act of 2009 – allows states to bring TILA actions and actions under certain FTC regulations re mortgage loans
- Interstate Land Sales Full Disclosure Act

Charter Conflicts

- Basic Rule – State consumer financial laws are preempted with respect to national banks in only three situations
 - While preemption is limited to three situations, the better reading is that there is no presumption against preemption with respect to those situations
- State Consumer Financial Laws – “State 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”
 - Example: State law that establishes a maximum loan-to-value ratio (LTV) for a mortgage loan, or a maximum debt-to-income ratio for an auto loan
 - Better interpretation is that state laws (such as state unfair business practices laws) which do not specifically regulate terms, etc., but as applied may restrict terms, are not included
 - Excludes transactions with corporate entities

Charter Conflicts (cont'd)

- Discrimination: Where the application of the state consumer financial law would have a discriminatory effect on national banks versus banks chartered by the state
 - Example: State law imposing a maximum LTV of 95% for state banks but 80% for all other lenders (including national banks)
- Barnett Bank: In accordance with the preemption standards set forth in the Supreme Court's *Barnett Bank* decision. The state consumer financial law may not prevent or significantly interfere with the exercise by the national bank of its powers under the NBA
 - Preemption determination may be made by a court, or by a regulation or order of the OCC on a case-by-case basis. The Bureau is not authorized to make these preemption determinations
 - A colloquy between Senators Dodd and Carper confirms that the legislation does not narrow the preemption standard established by *Barnett Bank*
 - Examples: State laws would be preempted if they purported to prohibit a national bank from making mortgage or consumer loans, discounting notes, or taking deposits

Charter Conflicts (cont'd)

- Other Federal Law: Where a federal law other than the CFPB preempts the state law
 - Example: 12 U.S.C. §1701j-3, which preempts certain state laws that purport to restrict the exercise of due-on-sale clauses in mortgage documents

OCC Preemption Determinations

- OCC preemption determination process for state consumer financial laws is designed to be as onerous and unpleasant as possible
- Case-by-Case – OCC preemption determinations for state consumer financial laws must be made on a case-by-case basis
 - In general, this means a separate determination for each individual state law
 - OCC need not do so if another state's law has substantively equivalent terms
 - OCC must consult Bureau and take Bureau's views into consideration in deciding whether another state's law has substantively equivalent terms
 - Separate determination for each individual national bank should not be necessary
 - Once the new law is effective, it will no longer be prudent to rely upon the preemptive effects of the OCC regulations at 12 C.F.R. §7.4002 (national bank charges), §7.4007 (deposit-taking), §7.4008 (non-real estate lending), §7.4009 (applicability of state law to national bank operations), and §34.4 (applicability of state law to real estate loans)

OCC Preemption (cont'd)

- Non-Occupation of Field – NBA does not “occupy the field” in any area of state law
- Substantial Evidence
 - State consumer financial law will not be preempted by OCC order or regulation unless “unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with the legal standard of the decision of [Barnett Bank].”
 - This may invoke the procedural safeguards imposed by the Administrative Procedures Act (APA), and thus additional obstacles for the OCC to navigate
- Standard of Review
 - Courts shall assess validity of OCC preemption determinations based on (i) the thoroughness evident in the OCC’s consideration, (ii) the validity of the OCC’s reasoning, (iii) the consistency with the OCC’s other valid determinations, and (iv) other factors that the court finds persuasive and relevant to their decision
 - This should not alter the *Chevron* deference that the courts afford OCC determinations
 - Better reading is that the court review is not a *de novo* review

OCC Preemption (cont'd)

- Non-Delegable Determinations – OCC preemption determinations for state consumer financial laws are not “delegable to another officer or employee of the [OCC].” Nothing precludes the Comptroller from using his/her staff to do research and prepare drafts
- Periodic OCC Reviews of Preemption Determinations
 - Mandatory OCC review of preemption determinations at least every five years
 - Review requires notice, the receipt of public comments, and publication of a notice in the Federal Register announcing the OCC’s decision to continue, rescind, or amend the preemption determination
 - Any notice of a proposal to amend, and the subsequent resolution of that proposal, must follow the existing procedural requirements of the NBA relating to preemption determinations.
 - The OCC must forward reports of its preemption reviews, and its decisions relating to preempted state consumer financial laws, to the House Financial Services Committee and Senate Banking Committee

OCC Preemption (cont'd)

- Interest Rate Exportation Doctrine – Nothing in the CFPA alters or otherwise affects the ability of national banks to utilize the interest rate exportation doctrine set forth at 12 U.S.C. §85. This specifically includes “the meaning of ‘interest’ under [12 U.S.C. §85].”
 - The better interpretation is that 12 C.F.R. §7.4001, which defines “interest” for purposes of §85, remains viable
 - Also, this should best be interpreted to include existing precedents relating to the preemption of state laws purporting to regulate interest calculation methods or purporting to impose notice requirements
 - §1027(o) of Dodd-Frank prohibits the Bureau from establishing usury limits, except where otherwise provided by law
 - OCC Chief Counsel interpretive opinions concluding that national bank operating subsidiaries may utilize the interest rate exportation doctrine are no longer viable

OCC Preemption (cont'd)

- National Bank Operating Subsidiaries – three separate provisions of Dodd-Frank state that national bank operating subsidiaries and affiliates (unless themselves chartered as national banks) do not enjoy the benefits of the NBA federal preemption doctrine
 - The inapplicability of federal preemption applies to both state consumer financial laws as well as other state laws
 - Operating subsidiaries will need to be merged up into the national bank parent or comply with all applicable state licensing and other laws
 - With Dodd-Frank, Congress has rejected the treatment of operating subsidiaries in 12 C.F.R. §7.4006 and the Supreme Court's 2007 decision in *Watters v. Wachovia Bank*
 - Operating subsidiaries will continue to enjoy the benefits of federal preemption where a separate federal law preempts state law or where state law itself provides an exemption for a national bank operating subsidiary

OCC Preemption (cont'd)

- Transparency of OCC Preemption Determinations – OCC must publish, at least quarterly, a “list of preemption determinations by the Comptroller . . . [that are] then in effect that identifies the activities and practices covered by each determination and the requirements and constraints determined to be preempted.”
- Federal Savings Associations – The preemption standards for federal savings associations have been brought into parity with those applicable to national banks

State Petitions to The Bureau

- States can ask the Bureau to issue new consumer protection regulations, or amend existing regulations
 - Requires a majority of the states to enact a resolution in support
 - In response, the Bureau must issue a notice of proposed rulemaking
 - Bureau must consider whether proposal would afford greater protection than existing rules; whether benefits would outweigh increased costs or inconveniences for consumers, and would not discriminate against any category or class of consumers; and whether a federal banking agency has advised of an unacceptable safety and soundness risk to insured depository institutions
- If final regulation is issued, Federal Register notice must discuss these 3 factors. Bureau may consider other factors as well
- If final regulation is not issued, Federal Register notice must provide an explanation. Copy to be forwarded to each of the petitioning states, House Financial Services Committee and Senate Banking Committee
- Bureau retains its power to issue and amend regulations on its own

State Enforcement Powers

- State attorneys general are authorized to bring actions against persons (other than national banks and federal savings banks) to enforce the CFPA and its regulations
 - Authority to pursue remedies provided by the CFPA
 - Authority to pursue remedies provided by other law
 - This is subject to the consultation requirement described below
 - Example: Action to enforce injunctive relief or civil money penalties, if authorized by applicable state law for a CFPA violation
 - Probably allows actions against national bank operating subsidiaries
- State regulators are authorized to bring actions against state licensed or chartered entities to enforce the CFPA and its regulations
 - Authority to pursue remedies provided by the CFPA
 - Authority to pursue remedies provided by other law
 - Example: Action to suspend a state bank's charter, if authorized by applicable state law for a CFPA violation
 - This is subject to the consultation requirement described below

State Enforcement Powers (cont'd)

- State attorneys general are authorized to bring actions against national banks and federal savings banks to enforce CFPA regulations
 - This is the exclusive pathway for the state attorneys general to bring such actions
 - This is subject to the consultation requirement described below
 - Actions may be brought in federal or state court
 - Wording of statute suggests that these actions may be brought only to enforce CFPA regulations, not the CFPA itself
 - State attorneys general may pursue remedies provided under the CFPA and those provided by other laws

State Enforcement Powers (cont'd)

- Consultation Requirement – State attorney general or state regulator must notify Bureau and any prudential regulator before filing a court or administrative action under the CFPA against a covered person
 - “Covered Person” means any person that offers or provides consumer financial products or services, or any affiliate that acts as a service provider to that person
 - Minimum notice requirements – identity of parties; alleged facts underlying the prosecution; whether there may be a need to coordinate the proceeding so as not to interfere with an action by the Bureau, a prudential regulator, or another federal agency. Must provide copy of “complete complaint” to be filed
 - Bureau (but not prudential regulator) may intervene in the action, remove the action to federal court, be heard on all matters, and appeal any order or judgment to the same extent as any other party
 - Prior notice not required where this is “not practicable.” In that event, notice must be provided immediately upon instituting the action or proceeding
 - Bureau to issue implementing regulations

State Enforcement Powers (cont'd)

- State attorneys general and state regulators are authorized to bring actions to enforce the Enumerated Consumer Laws as provided in those laws. This includes the FCRA, FDIA, GLBA, SAFE Act, and §626 of the Omnibus Appropriations Act of 2009
- State attorneys general and state regulators may bring actions or regulatory proceedings that arise solely under state law. State securities and insurance regulators may adopt rules, initiate enforcement proceedings, or take other actions

Preservation of Existing Contracts

- CFPB and its implementing regulations, orders, guidances and interpretations do not affect national bank and subsidiary contracts that are in existence before the date of enactment of Dodd-Frank (July 21, 2010)
- This creates an ambiguity because another provision states that Subtitle D becomes effective on the designated transfer date
 - The “designated transfer date” will be established by the Treasury Secretary, following consultation with other federal officials, within 60 days following enactment of Dodd-Frank. The date will be no earlier than 180 days, and no later than 12 months, following enactment. The Treasury Secretary can establish a designated transfer date beyond the 12-month period by following certain procedures, but the designated transfer date may not be more than 18 months following enactment

Existing Contracts (cont'd)

- The grandfathering provision is silent regarding several important issues
 - Whether there will be grandfathering treatment for items other than contracts (e.g., business practices). Silence should not be taken to mean that items which predate the effective date of the section will be deprived of federal preemption benefits
 - Whether there will be grandfathering treatment for the servicing of grandfathered contracts. The better analysis is that the grandfathering of the contract should include the continued application of federal law to the servicing of the contract
 - Whether there will be grandfathering treatment when a grandfathered contract is modified. The better analysis is that the contract retains its grandfathered status with respect to the existing terms, but is not grandfathered with respect to its new terms

Visitorial Powers

- The scope of the OCC's visitorial powers have been narrowed considerably
- Congress has codified the Supreme Court's 2009 decision in *Cuomo v. Clearing House Ass'n*, which held that the NBA's visitorial provisions do not preclude a state from bringing enforcement actions against national banks
 - State attorneys general enforcement actions against national banks must comply with Dodd-Frank provisions described above
 - State attorneys general are not authorized to enforce non-subpoena requests for information
- Federal Savings Associations – The visitorial powers relating to federal savings associations have been narrowed in the same manner as the visitorial powers relating to national banks
- Right of private parties to enforce rights granted under federal and state laws in federal and state court have been preserved

Additional Information

- See the detailed Federal Preemption User Guide, published at <http://www.mofo.com/resources/regulatory-reform/>
- Look under the heading “Dodd-Frank Act User Guides”

Contact Information

- Program presented by

Oliver Ireland

202.778.1614

oireland@mofo.com

Joseph Gabai

213.892.5284

jgabai@mofo.com

- Additional Contacts

Rick Fischer

202.887.1566

rfischer@mofo.com

Jeremy Mandell

202.887.1589

jmandell@mofo.com