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Cuomo v. Clearing House: State Enforcement Against Federally Chartered Banks

Preparing for Limited Federal Preemption and Heightened State Consumer Protection Enforcement

A Live 90-Minute Audio Conference with Interactive Q&A

Today's panel features:

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Tuesday, July 28, 2009

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Cuomo v. Clearing House: What Does it Mean for Federally Chartered Financial Institutions?

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July 2009

Overview

- Analysis of Supreme Court's ruling
- Impact of ruling on federally chartered financial institutions
- Anticipated agency and congressional action

Analysis of Supreme Court's Ruling

- Issue: visitorial exclusivity (not preemption of substantive state law)
- Questions presented:
  - Judicial deference to agency interpretations
  - "Visitorial" vs. enforcement powers

Background

- Cuomo sought information from national banks as a basis to sue under NY's fair lending law
- Office of the Comptroller of the Currency ("OCC") and the Clearing House challenged Cuomo's attempt based on the "visitorial" powers provision of the National Bank Act ("NBA"), 12 U.S.C. § 484 ("Section 484")
- OCC and Clearing House did not claim federal law preempted NY's fair lending law

Questions Cuomo Presented In the Supreme Court

- Whether 12 C.F.R. § 7.4000 (the OCC's visitorial powers regulation) is entitled to judicial deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)
- Whether 12 C.F.R. § 7.4000 is invalid because it is inconsistent with the Court's interpretation of the NBA in *First National Bank in St. Louis v. Missouri*, 263 U.S. 640 (1924)

12 C.F.R. § 7.4000

- In 12 C.F.R. § 7.4000, the OCC interpreted "visitorial powers" in NBA Section 484 to include:
  - Examination of a bank;
  - Inspection of a bank's books and records;
  - Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and
  - **Enforcing compliance with any application federal or state law concerning activities authorized or permitted pursuant to federal banking law**

The *Chevron* Deference Question

- Under *Chevron*, courts defer to an agency's interpretation of a statute if:
  - The statute is ambiguous, *and*
  - The agency's interpretation is "reasonable"
- The *Cuomo* Court did not alter the *Chevron* standard
  - The Court agreed NBA Section 484 is "ambiguous"
  - The majority and dissent disagreed on whether the OCC's interpretation of Section 484 was "unreasonable"

Majority's Application of the "Reasonable" Interpretation Test

- "The Comptroller can give authoritative meaning to [Section 484] within the bounds of [the statute's] ambiguity."
- "[T]he outer limits of the term 'visitorial powers' do not include . . . ordinary enforcement of the law."
- "Evidence from the time of the [NBA]'s enactment, a long line of our own cases, and application of normal principles of construction to the [NBA] make that clear."

Cuomo v. The Clearing House Ass'n, 129 S. Ct. 2710, 2715 (2009)

Implications for Judicial Deference In Future Cases

- *Chevron* remains a valid standard
- The courts may look to various sources, not just statutory text and legislative history, to find the meaning of statutory language
- Litigants may still invoke *National Cable & Telecommunications Association* v. *Brand X Internet Services*, 545 U.S. 967 (2005), regarding agency interpretations where courts have not opined

Effect of Ruling on 12 C.F.R. § 7.4000

- "The Comptroller reasonably interpreted [visitorial powers] to include 'conducting examinations [and] inspecting or requiring the production of books or records of national banks . . . .' "
- Thus, state authorities still may not "inspect books and records [of a national bank] on demand, even if the process is mediated by a court through prerogative writs or similar means."
- But when "a state attorney general brings suit to enforce state law against a national bank, . . . [s]uch a lawsuit is not an exercise of 'visitorial powers' . . . ."

Cuomo, 129 S. Ct. at 2721

State and Court Reactions to Date

- State attorneys general (”AGs”) are now threatening to bring a variety of suits against national banks

- At least one court has read *Cuomo* as undermining the NBA’s preemption of *state substantive law*. *Gawry v. Countrywide Home Loans, Inc.*, No. 1:07 CV 322, 2009 WL 1954717 (N.D. Ohio July 6, 2009), at *7

Litigation Strategies for Bank Defendants

- Remind courts early in litigation that *Cuomo* did not alter standards for federal preemption of substantive state law
- Emphasize that *Chevron* deference is still due to the OCC's interpretation of the NBA with respect to preemption of substantive state law
- Note that the *Cuomo* majority characterized the OCC's visitorial powers regulation as a "preemption" regulation and yet still applied *Chevron*

Impact of Ruling on Federally Chartered Financial Institutions

- **Investigations by state attorneys general**
- State fair lending laws
- Sub-prime lending litigation
- Financial products and services

Requirements for Suits by States

- In order to sue a national bank, a state must establish that:
  - The law sought to be enforced is not preempted by federal law, and
  - The state has sufficient factual information to assert a cause of action

States Must Meet Threshold Pleading and Evidentiary Standards

- A state AG will "risk sanctions if his claim is frivolous or his discovery tactics abusive. Judges are trusted to prevent 'fishing expeditions' or an undirected rummaging through bank books and records for evidence of some unknown wrongdoing." *Cuomo*, 129 S. Ct. at 2719
- A complaint must contain sufficient factual matter to "state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)

State Pleading Standards Are Now Tougher

- The Supreme Court very recently emphasized that "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Ashcroft v. Iqbal,* 129 S. Ct. 1937, 1949 (2009)
- Suits based on vague allegations may be challenged at the outset through motions to dismiss
- States will need to gather facts to avoid such motions

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As Recognized in *Cuomo*, Federal and State Fair Lending Laws Are Very Similar

- The federal Fair Housing Act prohibits discrimination in mortgage lending based on race, color, national origin, religion, sex, familial status, or handicap/disability. 42 U.S.C. §§ 3601-19
- The federal Equal Credit Opportunity Act prohibits discrimination in the extension of credit based on race, color, religion, national origin, sex, marital status, age, public assistance, or the exercise of Consumer Credit Protection Act rights. 15 U.S.C. § 691 *et seq.*

New York and Other State Fair Lending Laws Generally Proscribe the Same Conduct

- New York's human rights law prohibits discrimination in home lending on the bases of race, creed, color, national origin, sexual orientation, military status, age, sex, marital status, disability, or familial status
- California's Fair Employment and Housing Act prohibits discrimination in mortgage loans because of race, color, religion, sex, orientation, marital status, origin, ancestry, family, employment, or disability

National Banks Should Prepare for Greater Scrutiny of Their Fair Lending Compliance

- Enforcement of state fair lending laws against national banks is likely to increase as state AGs have now been empowered to sue
- The federal regulators may increasingly need to coordinate with state AGs and may adopt new supervisory and enforcement practices

Possible Preemption Defenses Based on Enforcement Standards and Remedies

- Although the basic federal and state fair lending law standards are the same, some preemption defenses may be viable
- To the extent that state enforcement methods or remedies conflict with Congress' intent for federal housing or fair lending law enforcement, the application of the state laws may be at least partially preempted
- If a particular application of a state fair lending law would restrict a national bank's authority to conduct banking activities authorized by federal law, such application may be partially or wholly preempted

Impact of Ruling on Federally Chartered Financial Institutions

- Investigations by state attorneys general
- State fair lending laws
- **Sub-prime lending litigation**
- Financial products and services

There Has Already Been Substantial Sub-Prime Lending Litigation

- In 2008, Arizona, Connecticut, Florida, Illinois, Iowa, Michigan, North Carolina, Ohio, Texas and Washington settled sub-prime lending claims against Countrywide Financial for $8.4 billion
- Buffalo has sued a number of banks and affiliates regarding their foreclosure practices. *City of Buffalo and Mayor Byron W. Brown v. ABN Amro Mortgage Co.*, No. 2008002200 (Erie Co., N.Y., Sup. Ct.)
- Baltimore has sued Wells Fargo, alleging that Wells Fargo targeted black neighborhoods in Baltimore for predatory mortgage loans. *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A., et al.*, Civil No. L-08-62 (D. Md.)

Example of Particularly Aggressive State Action Against Alleged Predatory Lending

- In 2007, the Massachusetts AG sued Fremont, a state bank, under state law regarding Fremont's lending practices
- In 2008, the court held that the loans were "presumptively unfair" and issued a injunction regarding foreclosure. *Commonwealth v. Fremont Inv. & Loan*, No. 07-4373-BLS1 (Mass. Super. Ct. Feb. 25, 2008)
- In 2009, the parties settled, under the terms of which Fremont must apply to the state AG before foreclosing

State Predatory Lending Laws May or May Not Be Preempted

- Many states have laws requiring additional disclosures, restrictions on terms and conditions, and delinquent borrower relief on predatory loans
- Under the preemption regulations of the Office of Thrift Supervision, much like those of the OCC, federal savings associations may extend credit as authorized under federal law without regard to non-federal laws purporting to regulate or otherwise affect their credit activities
- In 2006, the OTS found that federal law preempted sub-prime lending laws adopted by Montgomery County, Md. OTS Op. Ltr. P-2006-2

Post-*Cuomo*, Predatory Lending Litigation Is Likely To Increase

- The OCC and other federal banking regulators have addressed sub-prime/predatory lending issues largely through informal guidance, rather than formal rulemaking
  - Expanded Guidance for Subprime Lending (2001)
  - Guidelines to Guard Against Predatory Lending (2003)
  - Guidelines on Abusive Lending Practices (2000)
- Such guidance, while issued pursuant to general agency oversight authority, may have no preemptive effect on state laws

Impact of Ruling on Federally Chartered Financial Institutions

- Investigations by state attorneys general
- State fair lending laws
- Sub-prime lending litigation
- **Financial products and services**

Preemption of State Laws Regulating National Bank Products and Services

- Federal unfair and deceptive practices ("UDAP") law is very general
  - Section 5 of the Federal Trade Commission Act broadly prohibits "unfair or deceptive acts or practices affecting commerce." 15 U.S.C. § 45
  - Federal banking agencies enforce section 5 of the FTC Act
  - Guidance on Unfair or Deceptive Acts of Practices (March 2002)
- Now that state AGs are not barred from enforcement, we can expect more arguments that state UDAP laws survive federal preemption

State UDAP/Predatory Laws May Be Preempted Under Certain Circumstances

- State laws that treat national banks more harshly than state banks *are* likely preempted
- State laws that directly conflict with national banks' authority to conduct banking activities also are likely preempted
  - The Georgia Fair Lending Act, signed into law in 2002, restricted lenders from charging certain interest and fees and engaging in certain practices
  - Because of the conflict with federal law, in 2003, the OTS and the OCC declared that the Georgia law was preempted as to national banks

How to Deal Proactively with *Cuomo*

- Be prepared for an increase in suits against banks by state AGs and other state or local authorities
- Be aware that state AGs will probe all available sources for information on bank practices, such as HMDA data and consumer complaints, as well as banks' publicly-available marketing materials

Track Publicly Available Information

- Bank counsel should know who gathers and analyzes HMDA data
- Bank counsel should know who gathers and maintains consumer complaint information
  - OCC's Consumer Assistance Group
  - State AG consumer divisions
  - State and local housing authorities
- Bank counsel should ensure that the bank has in place well-documented methods for gathering and dealing with consumer complaints as they arise

Scrutinize Marketing and Customer Materials

- Bank counsel should review the bank's web site, marketing materials, application forms, customer agreements, call center scripts, and other materials to ensure that their statements and disclosures are in compliance with federal and state UDAP laws
- Bank counsel should ensure that the bank has systems and controls in place to address compliance with agency guidance documents on subprime and predatory lending practices

Possible Jurisdictional Defense: 12 U.S.C. § 1818(i)(1)

- "[N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order [by a federal banking agency]." 12 U.S.C. § 1818(i)(1)
- A state AG may therefore not obtain relief in court if such relief will "affect" the federal banking agencies' enforcement activities
- This provision was not addressed in *Cuomo*, where the Court interpreted only the much earlier-enacted NBA visitorial powers provision

Jurisdiction Is Clearly Removed Where an OCC Order Exists

- The first issue to consider with respect to any actual or threatened state action against a national bank is whether it would "affect" the exercise of the OCC's administrative enforcement authority
- If the OCC has issued an order, would the actual or threatened state action affect the order, such as by imposing differing or additional remedies?

Jurisdiction May Be Removed If an OCC Action Is Pending

- If the OCC has action pending, would the actual or threatened state action "affect" the OCC's action?
- "Ordering the remedies requested by the State to address financing-related violations would impermissibly affect the exercise of the OCC's administrative enforcement powers." *State of Arizona v. Hispanic Air Conditioning and Heating, Inc.*, CV 2000-003625, Superior Court of Arizona, Ruling at 27, Conclusions of Law, paragraph 53 (Aug. 25, 2003)

Might Jurisdiction Be Removed If an OCC Action Is Merely Possible?

- If the OCC has not acted and has not indicated any intention to act, could the state action nonetheless "affect" the OCC's enforcement powers by influencing the OCC's decision whether to act?
  - Issues of *res judicata* may arise where a state AG acts and then the OCC attempts to act
- Will be determined on a case-by-case basis
- Banks may want to resolve possible issues of concern informally with the OCC to create a preclusive effect

Anticipated Agency and Congressional Action

- Regulatory review under Obama's Preemption Memorandum
- Proposed Consumer Financial Protection Agency Act "clarification" of preemption

Obama Preemption Memorandum

- Issued on May 20, 2009, President Obama's Preemption Memorandum to Federal Agencies provides that:
  1. Agencies should not express intended preemption in regulatory preambles
  2. Agencies should not provide for regulatory preemption except where justified under governing legal principles
  3. Agencies must review all regulations issued within the past 10 years that are intended to preempt state law to determine if they are justified

What Effect Will the Memo Have on OCC/OTS Preemption?

- Neither the OCC nor the OTS have relegated statements of intended preemption to regulatory preambles only
- The OTS preemption regulations are outside the scope of the required review of regulations adopted in the past 10 years, but the OCC will need to review its preemption regulations
- Well-established Supreme Court precedent justifies both the OCC and the OTS preemption regulations
- Nevertheless, changes in personnel and responsibilities within the agencies could result in some regulatory amendments

Consumer Financial Protection Agency Act "Clarification" Of Preemption

- The proposed Consumer Financial Protection Agency Act would "clarify" preemption and visitorial standards for national banks and federal thrifts
- The Act would allow state AGs to bring lawsuits for the sole purpose of obtaining records relative to the investigation of violations of state consumer laws
- The Act would subject national banks and federal thrifts to "nondiscriminatory" state consumer laws of "general application"
- Thus, the Act would subject federally chartered financial institutions to state consumer protection laws that have historically been preempted

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