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PREEMPTION AND STATE ENFORCEMENT PROVISIONS IN THE PROPOSED FINANCIAL REGULATORY REFORM LEGISLATION WILL SIGNIFICANTLY ALTER THE PREEMPTION LANDSCAPE

I. INTRODUCTION

With the passage by the Senate last week of the Restoring American Financial Stability Act of 2010, amending the version of the bill previously passed by the House in December 2009,[1] the stage has been set for a significant change in the standards for federal preemption of state law with respect to the provision of financial services to consumers. Both the House and Senate versions of the legislation would create new standards for consumer protection and establish a federal agency—an independent Consumer Financial Protection Agency in the House bill and a Bureau of Consumer Financial Protection within the Federal Reserve in the Senate bill—with responsibility over the regulation and, subject to certain exceptions where other agencies continue to have this power, the supervision and enforcement of existing and new consumer financial laws. With limited exceptions for "inconsistent" state laws, the new federal consumer protection requirements and implementing regulations of the Consumer Financial Protection agency/bureau (the CFPA) would not preempt state law.

At least as importantly for national banks and federal savings banks and their respective subsidiaries, both the House and Senate versions of the legislation would alter existing preemption standards by specifically outlining new "clarifying" standards for preemption of state law by the National Bank Act (NBA), 12 U.S.C. § 21 *et seq.*, and the Home Owners' Loan Act (HOLA), 12 U.S.C. § 1461 *et seq.* These new standards would narrow the circumstances under which the NBA and HOLA could be deemed to preempt state law as applied to national banks, federal savings banks and operating subsidiaries of those federally chartered financial institutions, thereby altering the regulatory and litigation landscape under which these institutions operate. If these new standards are included in the final legislation—which they almost certainly will—the circumstances under which national banks and federal savings banks

1 The Senate adopted the number of the House Bill H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009. The Senate Bill was previously S. 3217. Arnold & Porter LLP has prepared a preliminary overview of the Senate Bill in title order, which is available at: http://www.arnoldporter.com/public_document.cfm?id=15890&key=17A2.

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may offer consumer products and services on a uniform, nationwide platform will be more limited and the costs of providing such services likely will be increased.

II. PREEMPTION CHANGES UNDER THE PROPOSED REFORM LEGISLATION

The House and Senate versions of the legislation contain similar, but not identical provisions relating to preemption. Specifically:

- Both bills' new substantive standards (statutory and regulatory) would preempt only "inconsistent" state laws, and only to the extent of the inconsistency. State laws providing greater protection for consumers would not be deemed "inconsistent" for this purpose. The CFPA would have authority to make determinations of whether a specific state law is "inconsistent" with the new federal standards.
- Other than through amendments made to the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. § 3801 *et seq*., the bills would not alter the preemption standards or preemptive effect of the existing federal "enumerated consumer laws" (which include the Truth in Lending Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Electronic Funds Protection Act, and the Truth in Savings Act, among others).
- If a majority of states adopted a resolution requesting a new or modified consumer protection regulation, the CFPA would have to propose such regulation, taking into account any views expressed by the other federal banking regulators.

III. NEW PREEMPTION STANDARDS UNDER THE NBA AND HOLA

Both bills set new standards for preemption under the NBA and the HOLA with respect to a "state consumer financial law," which is defined as a state law that "directly and specifically regulates the manner, content, or terms and conditions of any financial transaction…or any account related thereto, with respect to a consumer." The statutory language is unclear with respect to whether "state consumer financial laws" include only state truth-in-lending or similar statutes or whether more general consumer protection laws affecting financial transactions, such as state prohibitions on unfair and deceptive acts and practices, may also be covered.

- Under the new standards, the NBA and HOLA (and their respective implementing regulations) would be deemed to preempt a state consumer financial law *only if:* (1) the state law would have a discriminatory effect on a national bank or federal savings bank, respectively, in comparison with the effect of the law on a bank chartered by that state; (2) if the state law "prevented or significantly interfered with" a national bank's or federal savings bank's exercise of a federally granted banking power (as articulated in *Barnett Bank* v. *Nelson*, 517 U.S. 25 (1996); or (3) the state law were preempted by another federal law.
- A determination of preemption under these new NBA/HOLA standards could be made either a court or by the Comptroller of the Currency (Comptroller),[2] on a "case-by-case" basis. "Case-by-case basis," in this context, means a determination made by the Comptroller concerning the impact of a particular state consumer financial law on any national bank that is subject to that law.
- Both bills expressly provide that the NBA and HOLA will *not* preempt state law as applied to state-chartered subsidiaries, affiliates, and agents of national banks or federal savings banks, respectively (unless such entities are themselves national banks or federal savings banks).
- Importantly, the new NBA and HOLA preemption standards would not apply to any contract entered into by a national bank, federal savings banks, or affiliate or subsidiary thereof prior to the enactment of the legislation. The scope of this preservation of the preexisting preemption standards is not entirely

2 Only the Comptroller himself would have authority to make such preemption determinations. That authority would "not be delegable to another officer or employee."

clear, but its apparent intent is not to interfere with the expectations of the parties to a contract with respect to the law applicable to their agreement. It may be argued, therefore, that the new preemption standards do not apply to any actions taken by a national bank or federal savings bank in connection with the performance of obligations or the exercise of rights under credit card, deposit account, and similar agreements made with customers prior to the legislation's enactment.

- It is also important to note that these provisions would not affect the ability of any depository institution to export the interest rates of the state in which it is located to customers located in other states, effectively preempting the state usury laws of those other states. In the Senate, an effort by Senator Whitehouse (D-RI) to overturn this important precedent was defeated (and the issue was not addressed upon passage of the legislation in the House).

IV. COMPTROLLER DETERMINATIONS OF PREEMPTION

- Although the Comptroller would have authority to determine that a state consumer financial law is preempted by the NBA or HOLA, he could do so only by specifically identifying "*substantial evidence*, made on the record of the proceeding," supporting a finding of preemption under the *Barnett Bank* preemption standard.
- Under the House bill, the Comptroller could not determine a state consumer financial law to be preempted without identifying a specific federal law or regulation regulating the "particular conduct, activity, or authority" that is subject to the state consumer financial law. The Senate deleted this restraint on the Comptroller's authority from its bill pursuant to an amendment offered by Senator Thomas Carper (D-Del.) (the Carper Amendment).
- Moreover, in making a preemption finding regarding the state consumer financial law of a particular state, the Comptroller could not make a finding that a consumer financial law of another state "has substantively equivalent terms" as the law being preempted without first consulting with the CFPA and taking its views into consideration.
- All preemption determinations of the Comptroller would have to be published on a quarterly basis. The determinations also would be subject to mandatory review, through notice and public comment, within (i) the first five years after issuance, and (ii) at least once during every subsequent five-year period. The Comptroller would be required to report to Congress on whether, based on such reviews, he intends to continue, rescind, or propose to amend any of the existing preemption determinations.

V. PRESERVATION OF STATE ENFORCEMENT AUTHORITY

- In general, both the House and Senate bills would authorize a state Attorney General to bring a civil action in the name of the state to enforce these provisions and the regulations the CFPA may issue to implement them.
- Under the House bill, such an action could be brought by the state Attorney General as "*parens patriae*" actions, which would provide for damages relief to citizens of the state. The Senate eliminated the "*parens patriae*" reference pursuant to the Carper Amendment, while retaining the authority of state Attorneys General to sue.
- The Senate bill, also pursuant to the Carper Amendment, further circumscribes state Attorney General suits against national banks and federal savings banks specifically. In bringing actions against those entities, the Attorney General would have to allege a violation of a *specific regulation* promulgated by the CFPA; state Attorneys General could not simply allege a general violation of the CFP Act itself as a basis for suit. The House bill contains no such limitation.
- State Attorneys General would have to consult with the CFPA and the "prudential" (primary) regulator of an entity prior to initiating any enforcement actions against such entity (including but not limited to national banks and federal savings banks).
- The legislation also would preserve the Supreme Court's ruling in *Cuomo* v. *Clearing House Association, L.L.C.*, 129 S. Ct. 2710 (2009), that state Attorneys General may sue national banks for violations of non-preempted state law.

VI. IMPLICATIONS FOR NATIONAL BANKS AND FEDERAL SAVINGS BANKS

As indicated, the financial regulatory reform legislation, which almost certainly will become law, will alter the legal landscape for national banks and federal savings banks and their ability to offer products and services on a uniform, nationwide basis. For national banks, the new standards will codify existing precedent (i.e., *Barnett Bank*), but significantly limit the possible interpretation and application of that precedent. For federal savings banks, the standards will be new to them, as federal savings banks have always operated pursuant to a broad federal mandate under HOLA and its implementing regulations "occupying the field" of regulation with respect to deposit-taking and lending activities. *See* 12 C.F.R. §§ 557.11; 560.2(a). To adapt to these changes, federal savings banks as well as national banks will likely need to undertake a probing review of their policies and procedures in relation to state laws in the consumer area. In any event, regulatory and compliance costs will increase.

On the litigation front, all financial institutions subject to the legislation's new consumer protection provisions, including but not limited to national banks and federal savings banks, can expect an increase in aggressive plaintiffs' activities and the advent of broader actions by state Attorneys General. Defending against these actions on grounds of federal preemption will be a new challenge and will require both a solid understanding of preexisting precedent and the analytical skill to demonstrate that the new tests for preemption can be met under the new standards.

Arnold & Porter LLP's financial services litigation team is widely recognized for its successful preemption challenges to state and local enforcement actions against federally chartered financial institutions. In a series of cases, the Arnold & Porter team, including lawyers from the firm's Washington, DC, New York, and Los Angeles offices, has achieved major victories for national banks, savings and loan institutions, and credit unions threatened with overreaching state and local actions. The firm was recently included in the National Law Journal's *2010 "Appellate Hot List" for its work in the financial services sector, highlighting its success in the area of preemptive litigation for national banks.*

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