ARNOLD & PORTER LLP

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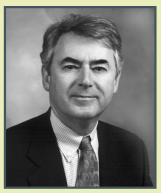
New Financial Regulatory Reform Act: Has it Materially Altered the Preemption Landscape for Federally Chartered Institutions?

The final financial regulatory reform legislation, now named the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act), contains provisions specifically addressing federal preemption of state law with respect to the provision of financial services to consumers. With limited exceptions for "inconsistent" state laws, the new federal consumer protection requirements and implementing regulations of the planned Consumer Financial Protection Bureau (CFPB) will not preempt state law. This construct is generally consistent with existing federal consumer protection law in the financial services area: the "inconsistent" preemption trigger governs most preemption under the Truth in Lending Act (TILA), Truth in Savings Act (TISA), and a number of other federal financial services statutes aimed at protecting consumers.

However, the Act not only establishes the "inconsistent" standard for its own new consumer protection mandates, but also amends 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.*, through "clarifying" standards for preemption of state law as applied to national banks and federal savings banks. These standards, which are essentially those contained in the prior Senate version of the legislation, in some respects narrow the circumstances under which the NBA and the HOLA may be deemed to preempt state law as applied to national banks and federal savings banks. Moreover, in a highly significant change, the Act eliminates those statutes' preemptive effect with respect to operating subsidiaries of those federally chartered financial institutions. As a result, the circumstances under which national banks and federal savings banks may offer consumer products and services on a uniform, nationwide platform may be more limited and the costs of providing such services may be increased.

The provisions concerning preemption, like most of the CFPB-related provisions in the Act, become effective no earlier than six months, and no later than 18 months (absent congressional approval for an extension to 24 months) after the date the Act is signed into law.

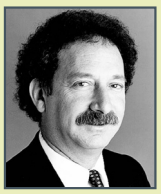
Contacts



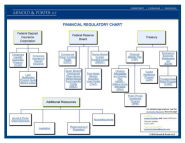
A. Patrick Doyle
+1 212.715.1770
+1 202.942.5949

Howard N. Cayne
+1 202.942.5656

John D. Hawke, Jr.
+1 202.942.5908



Laurence J. Hutt
+1 213.243.4100



Financial Regulatory Chart

Financial Regulatory Reform: *For Arnold & Porter's latest resources on this topic including Advisories, upcoming events, and publications, please visit Financial Regulatory Reform. Also visit our Financial Regulatory Chart, which aggregates information on US government programs.*

Preemption of State Law by Federal Consumer Protection Laws, Including the Reform Act Itself

Under the new Act:

- The Act's substantive consumer protection requirements (statutory and regulatory) will preempt only "inconsistent" state laws, and only to the extent of the inconsistency. State laws providing greater protection for consumers are not deemed "inconsistent" for this purpose. The CFPB will have the authority to make determinations of whether a specific state law is "inconsistent" with the new federal requirements.
- Other than through amendments made to the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. § 3801 *et seq*., there is no change to the preemption standards or preemptive effect of the existing federal "enumerated consumer laws" (which include the TILA, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Electronic Funds Protection Act, and the TISA, among others).
- To accommodate the states, if a majority of states adopt a resolution requesting a new or modified consumer protection regulation, the CFPB will have to propose such regulation, taking into account any views expressed by the other federal banking regulators.

Clarification of Preemption Standards Under the NBA and HOLA

The Act amends both the NBA and the HOLA to add "clarifying" standards for preemption of "state consumer financial laws." As defined in the Act, a "state consumer financial law" is 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." This definition is somewhat ambiguous in scope, but its focus on consumers indicates that other state banking-related laws (bank registration requirements, etc.) may continue to be preempted without regard to the Act.

- As amended, the NBA and the HOLA will no longer preempt state law as applied to state-chartered subsidiaries and affiliates of national banks or federal savings banks (unless such entities are themselves national banks or federal savings banks). This is a highly significant change in the law and effectively reverses the holding of *Watters* v. *Wachovia Bank, N.A*., 550 U.S. 1 (2007), in which the US Supreme Court held that state law is preempted as applied to an operating subsidiary of a national bank to the same extent as it is preempted for the national bank itself.
- With respect to national banks and federal savings banks themselves, the NBA and HOLA (and their respective implementing regulations) will be deemed to preempt a state consumer financial law *only if:* (i) the state law would have a discriminatory effect on a national bank or federal savings bank in comparison with the effect of the law on a bank chartered by that state; (ii) under the legal standard for preemption articulated in *Barnett Bank* v. *Nelson*, 517 U.S. 25 (1996), the application of the state law would "prevent or significantly interfere with" a national bank's or federal savings bank's exercise of a federally granted power; or (iii) the state law is preempted by another federal law.
- A determination of preemption under these NBA and HOLA standards may be made either by a court, or, subject to certain procedural limitations, by the Comptroller of the Currency (Comptroller).[1] In particular, the Comptroller's decisions must be made on a "case-by-case" basis; thus, presumably, they must address the impact of the NBA or the HOLA on a particular state consumer financial law as applied to a particular national bank or federal savings bank.
- Importantly, these NBA and HOLA preemption standards would not apply to any contract entered into by a national bank, federal savings bank, or affiliate or subsidiary thereof prior to the enactment of the legislation. The scope of this preservation of the preexisting preemption

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

standards is not entirely clear, but Congress' 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.

- Importantly, the Act's preemption provisions will *not* affect the ability of any depository institution to "export" the interest rates permissibly charged in the state in which it is located to customers located in other states. Thus, with respect to interest rates specifically, federal law will continue to preempt the application to a depository institution (subject to certain exceptions) of usury laws of states other than the one in which the institution is located.

Comptroller Determinations of Preemption

- As noted, the Comptroller's decisions on NBA and HOLA preemption are to be made on a "case-by-case" basis. However, there is some leeway in the Act for broader determinations, if the Comptroller involves the CFPB. Specifically, the Comptroller may, in making a preemption finding regarding the state consumer financial law of a particular state, also determine that another state's similar law is similarly preempted, provided that the Comptroller (i) first consults with the CFPB; and (ii) takes its views into consideration.
- The Comptroller's authority to determine that a state consumer financial law is preempted by the NBA or HOLA is also limited by the requirement that there be "*substantial evidence*, made on the record of the proceeding," supporting the finding of preemption under the *Barnett Bank* preemption standard.
- All preemption determinations of the Comptroller will have to be published on a quarterly basis, and must be reviewed periodically. The required reviews will involve a notice-and-comment process which, for each preemption determination, will occur within (i) the first five years after issuance, and (ii) at least once during every subsequent five-year period. The Comptroller will have to report to Congress on whether, based on such reviews, the Comptroller intends to continue, rescind, or propose to amend any of the existing preemption determinations.

Preservation of State Enforcement Authority

- The Act authorizes state Attorneys General to bring civil actions in the name of their states to enforce the Act's consumer protection mandates and the implementing regulations of the CFPB.
- State Attorneys General will have to consult with the CFPB and the "prudential" (primary) regulator of an entity prior to initiating any enforcement actions against such entity.
- With respect to enforcement actions against national banks and federal savings banks (but not other institutions), state Attorneys General may not simply allege a general violation of the Act but, rather, must alleged a violation of a *specific implementing regulation* promulgated by the CFPB.
- As a further limitation on state actions against national banks and federal savings banks, the Act preserves 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, but may not conduct examinations or pre-litigation investigations of national banks. The Act extends this ruling to cover federal savings banks as well.

Implications for National Banks and Federal Savings Banks

Very likely, the most significant aspect of the above-described changes for national banks and federal savings banks will be the elimination of preemption under the NBA and the HOLA for such institutions' operating subsidiaries. This change may prompt many national banks and federal savings banks to "roll up" their operating subsidiaries to make them bank divisions, rather than separate entities organized under state law. There could be efficiency losses and operational costs associated with such "roll-ups," and those will need to be weighed against

the efficiency and operational benefits of the nationwide uniform regulation resulting from federal preemption of the various states' laws.

With respect to the substantive standards for preemption under the NBA and the HOLA, the Act's impact on national banks will to some extent be limited by the fact that the NBA amendments primarily codify existing precedent (i.e., *Barnett Bank*). For federal savings banks, however, which arguably have enjoyed a broader scope of preemption than is provided by the *Barnett Bank* "prevent or significantly interfere" standard, the impact could be greater. Specifically, federal savings banks have operated pursuant to a "field preemption" standard under the preemption regulations of the Office of Thrift Supervision (OTS), *see e.g.*, 12 C.F.R. §§ 557.11; 560.2(a), which permits a finding of preemption without demonstrating a "conflict" between federal and state law.

The Act does not explicitly dictate any change to the current preemption regulations of the Office of the Comptroller of the Currency (OCC) under the NBA or the parallel OTS preemption regulations under the HOLA. However, both sets of regulations will need to be revisited to determine their continued viability in light of the Act. Under those regulations, certain types of state laws are categorically preempted, which may be deemed inconsistent with the Act's requirement that the Comptroller's preemption determinations be made on a "case-by-case" basis. Further, the OTS regulations expressly rely on the "field preemption" standard and thus would appear to require revision at least to conform to the *Barnett Bank* standard. An assessment of the continued viability of OCC and OTS preemption regulations will be a key focus for the agencies as they work on implementing the various mandates of and changes to current law contained in the Act. Of course, the political climate may influence the outcome of this assessment.

On the litigation front, all financial institutions subject to the Act'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 require both a solid understanding of preexisting precedent and the analytical skill to demonstrate that these "clarifying" tests for preemption are met.

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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. In addition, members of our financial services team held senior positions with the OCC, which will be required to implement these standards. We would be pleased to assist with questions on these matters.

If you would like more information about any of the matters discussed in this advisory, please contact your Arnold & Porter attorney or:

A. Patrick Doyle
+1 212.715.1770
APatrick.Doyle@aporter.com

Howard N. Cayne
+1 202.942.5656
Howard.Cayne@aporter.com

John D. Hawke, Jr.
+1 202.942.5908
John.Hawke@aporter.com

Laurence J. Hutt
+1 213.243.4100
Laurence.Hutt@aporter.com

Nancy L. Perkins
+1 202.942.5065
Nancy.Perkins@aporter.com

Beth S. DeSimone
+1 202.942.5445
Beth.DeSimone@aporter.com