

Preemption of State Consumer Protection Laws: Dodd-Frank Changes and the New (Old) Barnett Standard

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National Elder Rights Training Project for the National Legal Resource Center.
Sponsorship for this Webinar is provided by the National Consumer Law Center

and a grant from the Administration on Aging.

November 29, 2011

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- She has testified before Congress and contributes to several NCLC publications, including Fair Credit Reporting, Fair Debt Collection, Foreclosures, and Consumer Banking and Payments Law.

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Preemption of State Laws: The New (and Old) *Barnett* Standard

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Overview

- Basics (very brief)
- State of Bank Preemption in 2010: Pre-Dodd-Frank Preemption World
- What Dodd-Frank Did to Bank Preemption
- The OCC's Attempt to Implement Dodd-Frank
- *Barnett* Standard

What is Preemption?

Federal Preemption is:

The principle (derived from the Supremacy Clause) that a federal law can supersede or supplant any inconsistent state law or regulation.

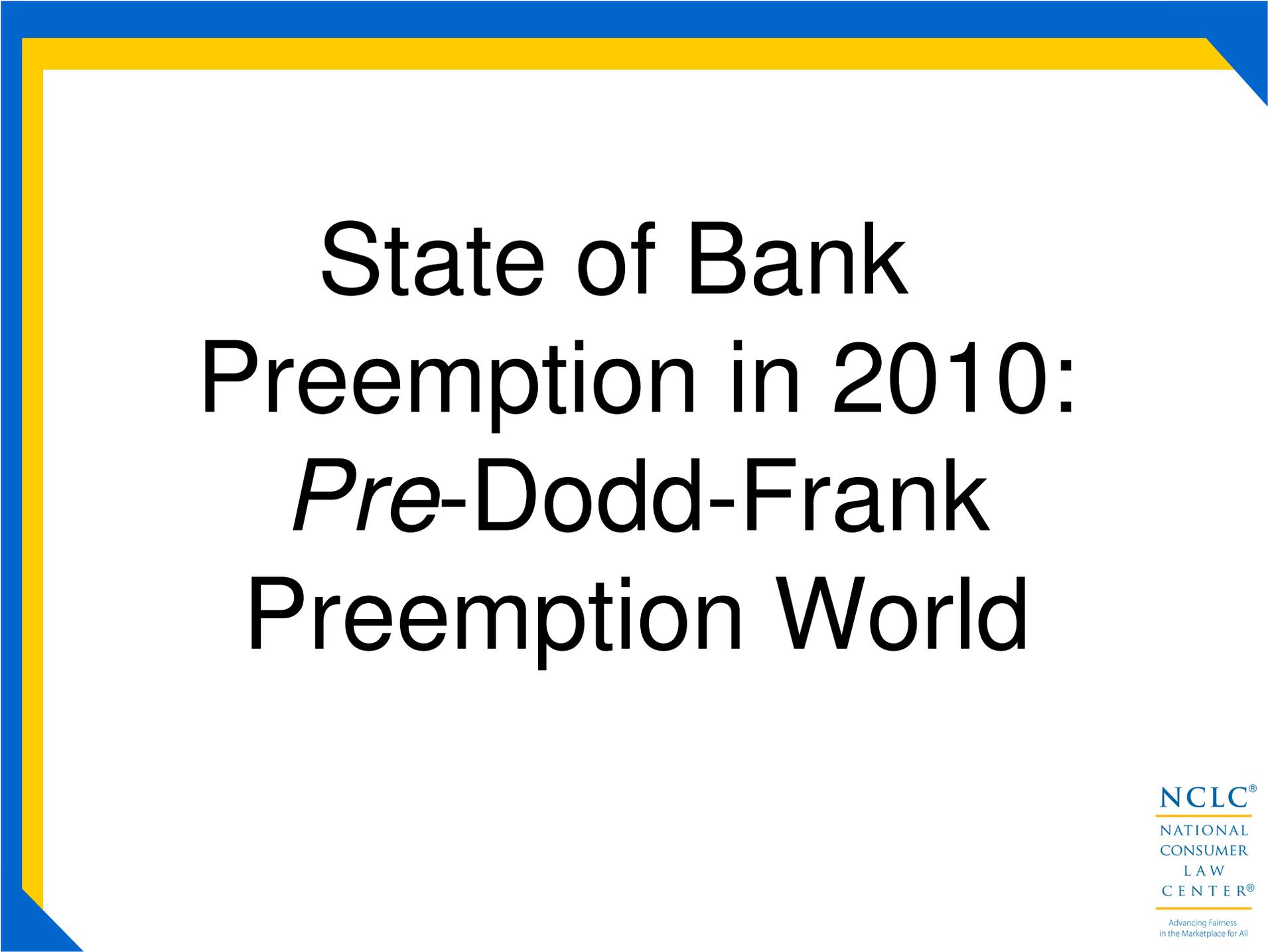
Source: Black's Law Dictionary (9th ed. 2009).

Preemption Can Be --

- **Express Preemption:** a federal law explicitly overrides state law
- **Implied Preemption:**
 - a) impossible to comply with both state and federal requirements, or
 - b) state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’

Implied Preemption

- **Conflict Preemption:** state law is inconsistent or conflicts with federal law
- **Field Preemption:** federal law “occupies the field” and ousts all state laws in that area, even those that could be consistent w/ federal law



State of Bank Preemption in 2010: *Pre-Dodd-Frank* Preemption World

Pre-Dodd-Frank Preemption in 2010

Home Owners' Loan Act (Federal Savings Ass'ns) Office of Thrift Supervision

- In 1996, OTS aggressively issued preemption regulations under HOLA
- Occupies field for deposit-taking, lending regulation
- Most state lending/deposit-taking laws preempted
- Listed exceptions where **only incidentally affect** lending operations

Pre-Dodd-Frank Preemption in 2010

National Bank Act (National Banks)

Office of the Comptroller of the Currency

- OCC starts gradually, picks up steam
- 2004: De facto field preemption for deposit-taking, lending regulation
- Preempts state laws that **obstruct, impair, or condition** a national bank's ability to fully exercise federally granted powers
- Field preemption of usury laws

Examples of Preempted Laws

- GA law prohibiting prepayment penalties, balloon payments, negative amortization, penalty rates, other terms on high-cost loans.
- CA law giving consumers until next business day when obligation (credit card payment) falls on a holiday.
- NY law requiring payment of interest on escrow funds
- CA ban on unfair, deceptive practices as applied to loan with 1.5% initial rate, 3 year payment schedule based on that rate, w/o disclosure that rate would shoot up in 30 days and immediately began negatively amortizing.

Major Pre-Dodd-Frank Cases

- **Cuomo (2002)**: States can enforce non-preempted fair lending laws but only in litigation, can't do pre-litigation subpoenas
- **Wachovia (2007)**: Preemption regulations apply to nonbank mortgage lending subsidiaries (*rev'd by Dodd-Frank*)
- *Both cases are visitation, not preemption*

Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Preemption Basics

- NBA and HOLA subject to same preemption standards; OTS abolished.
- No field preemption under HOLA (or NBA)
- Clarified preemption standard for “**State Consumer Financial Laws**”
- New preemption procedures for OCC
- *Skidmore*, not *Chevron*, deference for OCC preemption determinations

Effective Date

- Effective July 21, 2011
- Grandfather clause for contracts entered into on or before July 21, 2010: Dodd-Frank does not alter applicability of prior regs.
- But since DF “clarifies” law, could influence interpretation of prior law.

Dodd-Frank Preemption Basics

“State consumer financial law” is a law that:

- does not discriminate against nat’l banks
- “directly and specifically regulates” manner, content, terms, conditions of any financial transaction, accounts
- re consumers

Dodd-Frank is silent on other laws

Dodd-Frank Preemption Basics

NBA and HOLA preempt state consumer financial law “only if” the law:

(1) discriminates against national banks,

(2) conflicts with federal law other than NBA,

or...

Prevent/significantly interfere standard

(3) if, “in accordance with the legal standard for preemption in ... *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner et al.*, 517 U.S. 25 (1996), the State consumer financial law **prevents or significantly interferes** with the exercise by the national bank of its powers.”

Interest rate Preemption Preserved

- Effectively codifies SCT 1978 Marquette and 1996 Smiley cases.
- Marquette: Banks can still charge “interest” rates permitted by their home state.
- Smiley: OCC retains power to define “interest” to include fees.

Dodd-Frank Preemption Basics

New OCC Preemption Process

- Only on case-by-case basis
 - particular state law
 - substantially equivalent laws (with CFPB consultation)
- Comptroller cannot delegate

Dodd-Frank Preemption Basics

- OCC may only preempt by regulation (subject to notice and comment)
- Determination requires **substantial evidence on the record** to support **specific finding** of preemption in accordance with Barnett
- 5-year review of decisions
- publish list quarterly

Dodd-Frank Preemption Basics

Clarified judicial review standard

Skidmore, not *Chevron*, deference to OCC preemption determinations

- A court "shall 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** with other valid determinations made by the agency, and other factors which the court finds **persuasive** and relevant to its decision." 12 USC 25b (emph. added)

Dodd-Frank Silent on General Laws

- What if not a “state consumer financial law”?
- Our view:
 - NBA specified where & how OCC can preempt. Otherwise, it can't.
 - Other laws preempted only under traditional preemption principles (conflict/Barnett)
 - Presumption against preemption
- OCC view: has the power to preempt other types of laws but generally hasn't done so.
- UDAP laws shouldn't “significantly interfere”

- **Questions** on the basics of the Dodd-Frank changes to preemption?
- Next:
 - The OCC's revised preemption regulation
 - The Barnett/significantly interfere standard

Revised OCC Preemption Rules (effective July 21, 2011)

The Good:

- Rescinded subsidiary preemption.
- Rescinded preemption of laws impairing banks' "incidental powers." (12 CFR 7.4009)
- Conformed HOLA preemption to NBA.
- Codified *Cuomo* (AG enforcement of federal, nonpreempted state laws).

New OCC Preemption Standard: The more things change...

- Removed “occupy the field” language in HOLA.
- Removed statement that laws preempted if “obstruct, impair, or condition” or have more than an “incidental” effect on bank powers.
- ***But*** kept laundry list of preempted deposit-taking, lending law (and, under HOLA, fiduciary laws).
- Applied *Barnett* only to qualify list of general laws ***not*** preempted.

OCC Violated Dodd-Frank

- De facto field preemption, no “case-by-case” review of “particular” state laws.
- Refused to follow “prevents or significantly interferes” standard (or even *Barnett*).
- OCC can issue “no regulation or order” preempting under *Barnett* “unless substantial evidence, made on the record of the proceeding” supports preemption.

OCC's Bizarre View of Retroactivity

- DF has “no statement that Congress intended to retroactively apply these procedural requirements to overturn existing precedent and regulations, and that interpretation would be contrary to the presumption against retroactive legislation. *See, e.g., Landgraf v. USI Film Products*, 511 U.S. 272-73 (1994).”
- Ignores limited DF *grandfather clause* for preexisting contracts, not regs.
- *Landgraf* is about when new law applies to prior conduct, not perpetuating old regs when the law has changed.

So What Really Changed?

Dodd-Frank Was a Compromise:

- Original Obama proposal: No preemption unless discrimination or conflict with another statute; no role for OCC.
- Preemption proponents: Status quo (either through no amendments or codification)
- Dodd-Frank: Limited role for OCC on strict terms, return to 1996 and *Barnett* standard.

Barnett Bank v. Nelson (1996)

- Federal law authorizing banks to act as insurance agent in towns of 5,000 or less preempted Florida law prohibiting that power.
- Classic, unremarkable conflict preemption.

Barnett Standard

“[Our] cases take the view that normally Congress would not want States to **forbid, or to impair significantly,** the exercise of a power that Congress explicitly granted. **To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank’s exercise of its powers.”**

State of Preemption in 1996

- Interest rates (and, soon, fees) preempted.
- Certain mortgage terms (AMTPA)
- No broad NBA/HOLA preemption regs.
- Interstate banking just taking off.
- Riegle-Neal Act of 1994: Consumer protection laws of host state apply to out-of-state branches unless federal law preempts or OCC finds discriminatory effect.

Most Supreme Court Bank Preemption Cases Fall in Discrete Categories:

- Taxation (pro & con preemption)
- Visitation (express NBA preemption)
- Bank insolvency (like visitation)
- Usury (express NBA preemption)

SCT Cases Cited in Barnett Preempting State Laws

Easton v. Iowa (1903)

First NB of San Jose v. CA (1923)

Franklin Nat'l Bank of Franklin Square v.
People (1954)

Fidelity Fed S&L Asso. v. De La Cuesta (1982)

Easton v. Iowa (1903)

- Preempted ban on insolvent banks accepting deposits
- NBA gives OCC exclusive authority to determine if bank is insolvent, and if so, wind up its affairs; states cannot interfere with powers bestowed by Congress

=> Similar to visitation, express preemption

First Nat'l Bank of San Jose v. CA (1923)

- Escheat w/o proof of abandonment threatened “possible confiscation” of depositors’ funds and “significantly interfered” with power to accept deposits.
- → “significantly interfere” is close to prevent

Franklin Nat'l Bank v. People (1954)

- NY can't prohibit banks other than state savings banks from using word "savings" in their name or advertising.
- Congress gave national banks power to accept savings deposits and states can't prohibit them from letting the public know.
- → Prevent, discrimination

Fidelity Fed S&L Asso. v. De La Cuesta (1982)

- OTS considers due-on-sale clauses “essential to the economic soundness of the thrift industry.”
- State ban creates “an obstacle to the accomplishment and execution of the full purposes and objectives” of OTS reg.
- → Severe interference with ability to make mortgages, essentially “prevents”.

Notable SCT Cases Cited in Barnett NOT Preempting State Laws

- Nat'l Bank v. Commonwealth (1869)
- Waite v. Dowley (1876)
- Anderson NB v. Lockett (1944)
- (others)

First SCT NBA Preemption Case: National Bank v. Commonwealth (1869)

- NBA doesn't preempt state laws taxing national bank shares.
- National banks “are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation.... **It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.**”

McClellan v. Chipman (1896)

- State law voiding preferential transfers by insolvent debtors not preempted.
- **“No function of banks is destroyed or hampered** by allowing the banks to exercise the power to take real estate, provided only they do so **under the same conditions and restriction** to which all the other citizens of the state are subjected.”

Anderson NB v. Lockett (1944):

- States can require banks to transfer dormant accounts to state for escheat proceedings.
- Distinguished 1923 case: that law altered “the contracts of deposit in a manner considered so unusual and so harsh in its application to depositors as to deter them from placing or keeping their funds in national banks.”
- Note: OCC preempts laws concerning “abandoned and dormant accounts” but needs footnote to exempt law in *Anderson*.

So What Will Happen in the Courts?

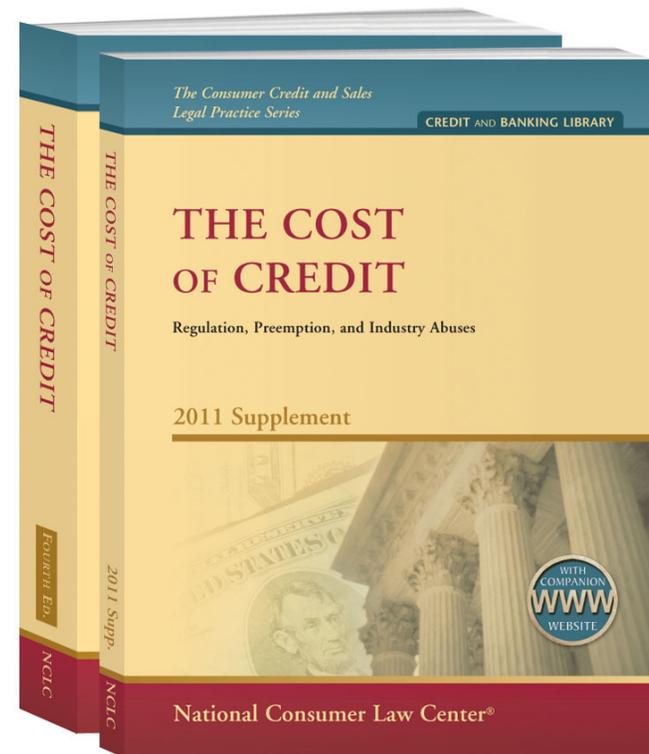
- General laws, debt collection, doing well.
- Old OTS cases being rejected.
- Little analysis of Dodd-Frank yet.
- No cases on validity of revised OCC reg.
- OCC may give broad sweep to “significantly interfere” and “substantially equivalent”
- Jury still out on court reaction

Questions?

For more information:

NCLC.org (Issues,
Consumer Protection
Regulation &
Preemption)

NCLC's Cost of Credit:
Regulation, Preemption
and Industry Abuses



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