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THE ROLE OF THE STATES

UNDER THE

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010

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Introduction and Executive Summary

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 overhauls the federal consumer protection system. The Act creates a Consumer Financial Protection Bureau charged with protecting consumers from unscrupulous practices by mortgage lenders, credit card companies, and others in the financial world.

While the emphasis in the bill is on a revamp of deficient federal protections, the Dodd-Frank Act also restores the partnership with states. Various provisions of the Act enhance states' ability to protect consumers in their financial lives.

Under the Dodd-Frank Act, state attorneys general and, to a lesser extent, state regulators can directly enforce several aspects of federal law:

- The *generic ban* on unfair, deceptive *or abusive* conduct against covered persons except national banks, federal thrifts and certain merchants who offer credit.
- *Rules* of the Consumer Financial Protection Bureau (CFPB) against covered persons, including banks and thrifts, except certain merchants who offer credit.
- *New mortgage provisions* regarding ability to repay, steering, prepayment penalties, escrows, appraisals, prompt crediting of payments, and payoff amount requests (including against banks and thrifts).
- *Federal statutes* like the Truth in Lending Act and the Fair Credit Reporting Act, against banks, thrifts and others, to the extent authorized by the statute.

Dodd-Frank also limits the ability of banks and others to ignore state consumer protection laws through the doctrine of preemption:

- *Subsidiaries* of national banks and federal thrifts are no longer entitled to preemption (reversing the *Watters v. Wachovia* case).
- Mortgage laws and other specific consumer protection laws are preempted only if they *prevent or significantly interfere* with national bank or federal thrift powers under the standard of the 1996 *Barnett* case. Federal preemption regulations should have to be revised and will be subject to closer judicial review.
- *General state laws,* like those against unfair or deceptive practices, should be less subject to preemption.
- The Alternative Mortgages Parity Transactions Act, which currently preempt state laws *regulating certain mortgage terms* as to anyone (including nonbanks), has largely been repealed.
- The new rules of the *CFPB will not generally preempt* more protective state laws.
- *Bank interest rate preemption remains* and has been codified.
- *Nonpreempted state laws* can be enforced against banks and thrifts (codifying the *Cuomo* case).

The partnership with the states is vital part of our system of federalism and our consumer protection system. States will have no need to duplicate federal efforts. But the Dodd-Frank Act appropriately recognizes that states have a crucial role to play in protecting consumers. States can help ensure that everyone complies with federal law, can prevent gaps in federal protections from being exploited, and can act as first responders when new problems arise that have not yet reached the national level.

I. Enforcement of Federal Consumer Protection Laws

A. *The Consumer Financial Protection Act*

The Consumer Financial Protection Act (CFPA) is Title X of the Dodd-Frank Act.[1] The CFPA directly prohibits a covered person from engaging in "any unfair, deceptive, or abusive act or practice" in connection with financial products and services.[2] The CFPA also creates a federal Consumer Financial Protection Bureau (CFPB) empowered to write specific rules and engage in other activities to prevent such practices.

The CFPA gives state attorneys general and state regulators the power "to enforce provisions of this title *or* regulations issued under this title, and to secure remedies under provisions of this title or remedies otherwise provided under other law."[3] **Therefore, subject to some exceptions, AGs and state regulators can enforce *both* the generic ban in Title X against unfair, deceptive or abusive conduct *and* any specific rules that the CFPB enacts.** The generic prohibition[4] is in addition to the CFPA's prohibition against offering or providing a product or service that is not in conformity with more specific rules issued by the CFPB.[5]

The ability to enforce the generic ban on unfair, deceptive or abusive acts or practices (UDAAP) may be especially helpful:

- in states that have holes in their state unfair or deceptive acts and practices (UDAP) statutes;
- as a counter to any claim that a state UDAP statute is preempted;
- if the conduct is "abusive" but not as clearly unfair or deceptive.

"Unfair" is defined in an identical fashion to the Federal Trade Commission Act,[6] and "deceptive" is not defined but should be no different. The ban against "abusive" conduct, however, is new.[7] The CFPA defines "abusive" as an act or practice that:

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[1] Pub. L. No. 111-203, Tit. X, § 1001-1100H, 124 Stat. 1376 (July 21, 2010) ("Dodd-Frank").
[2] Dodd-Frank § 1036(a)(1)(B).
[3] *Id.* § 1042(a)(1) (emphasis added).
[4] *Id.* § 1036(a)(1)(B).
[5] *Id.* § 1036(a)(1)(A).
[6] *Id.* § 1031(c).
[7] Though the Home Owner's Equity Protection Act gives the Federal Reserve Board the authority to issue regulations to ban "abusive" mortgage lending practices, 15 U.S.C. § 1639(l)(2)(B), the term is not defined and it has never been used independently of the unfairness authority.

(1) materially interferes with a consumer's ability to understand a term or condition of a consumer financial product or service; or
(2) takes unreasonable advantage of—
(A) a consumer's lack of understanding of the material risks, costs, or conditions of the product or service;
(B) a consumer's inability to protect his or her own interests when selecting or using a product or service; or
(C) the consumer's reliance on a covered person.[8]

As a practical matter, most acts that are abusive will also be considered deceptive or unfair, but the added definition could be useful in some contexts.

There are only two limitations on this state enforcement authority. First, state AGs **can enforce CFPB *rules* against national banks and federal thrifts but *not* the generic UDAAP ban**.[9] AG authority over federal credit unions is not addressed or limited. AGs must provide prior notice to the CFPB and the prudential regulator if they take action against a national bank or federal thrift, and the CFPB (and possibly the regulator) has the right to intervene in the action.

Second, **neither the CFPB nor state AGs or state regulators can enforce either the generic UDAAP ban or UDAAP rules against *certain merchants, retailers or sellers* who directly offer credit for their own nonfinancial goods or services**.[10] This provision primarily applies to entities that are small businesses.[11] However, nothing limits AGs' or regulators' ability to use CFPB rules as a basis for arguing that a merchant, retailer or seller has violated the *state law* ban on unfair or deceptive practices. Moreover, the ban on enforcement of the CFPA's UDAAP ban and CFPB UDAAP rules does not restrict the AGs or state regulators from enforcing other federal laws such as the Truth in Lending Act to the extent the other statute authorizes such enforcement.[12]

AGs may have an important role to play in enforcing CFPB rules against entities over which the CFPB lacks authority. In particular, AGs, but not the CFPB, can enforce CFPB rules against **banks, thrifts and credit unions under $10 billion (federally or state chartered)**[13] and **attorneys**[14] whose client is the consumer.

AGs also **can enforce the generic UDAAP ban against auto and other vehicle dealers**. Though vehicle dealers are subject to the general UDAAP ban if they offer financial

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[8] *Id.* § 1031(d).
[9] *Id.* § 1042(a)(2).
[10] *Id.* § 1027(a)(2)(E).
[11] The exemption of merchants, retailers and sellers does not apply to those that regularly extend credit subject to a finance charge, *Id.* § 1027(a)(2)(B)(iii), unless they are not "significantly engaged" in offering financial products or services, *id.* § 1027(a)(2)(C)(i). Small businesses are deemed not to be significantly engaged. *Id.* § 1027(a)(2)(D)(ii).
[12] *Id.* § 1027(a)(2)(C)(ii)(II).
[13] The prudential regulator enforces CFPB rules.
[14] The Federal Trade Commission has enforcement power.

products or services, the CFPB has no rulemaking power over most vehicle dealers. Dodd-Frank gives the FTC new rulemaking power over unfair or deceptive practices by auto dealers, but FTC Act rules are not enforceable directly by AGs. FTC rules may be enforced indirectly, however, through state UDAP statutes (and the CFPA's generic UDAAP ban as well).

B. New TILA mortgage protections

The Dodd-Frank Act adds new protection for mortgages to the Truth in Lending Act (TILA).[15] Several of these are specifically made enforceable by state AGs, including provisions governing:

- ability to repay;
- steering;
- prepayment penalties;
- escrows;
- appraisals;
- prompt crediting of payments; and
- payoff amount requests. [16]

These provisions may be enforced against anyone, including national banks and federal thrifts (see next section).

C. States Can Enforce Certain Federal Statutes Against National Banks and Federal Thrifts

Dodd-Frank clarifies that state AGs can enforce federal statutes against national banks and federal thrifts if the statute itself gives AGs enforcement rights.[17] For example, in addition to the new mortgage provisions listed above, AGs have the authority to enforce the Home Ownership and Equity Protection Act's high-cost mortgage provisions[18] and the Fair Credit Reporting Act's (FCRA) furnisher provisions.[19] The latter is significant because individuals cannot enforce the FCRA's requirement that banks, and others who furnish information to credit reporting bureaus, provide accurate information.

II. Preemption of State Consumer Protection Laws

Dodd-Frank makes several changes to preemption that enhance the role of states and their ability to enact and enforce state laws.

[15] For a longer discussion of the new mortgage protections, see NCLC Reports Special Double Issue on the Dodd-
Frank Financial Reform Bill (Vol 29, July/August 2010), available at www.nclc.org/dodd-frank.
[16] Dodd-Frank § 1422, *to be codified at* 15 U.S.C. § 1640(e).
[17] Dodd-Frank § 1042. Though the Act does not address AG enforcement of state or federal laws against federal credit unions, the National Credit Union Administration has been less aggressive than the bank regulators in preempting state activities.
[18] 15 U.S.C. §§ 1639, 1640(e).
[19] 15 U.S.C. §§ 1681s-2, 1682s-2(d).

A. *No Preemption for Bank Subsidiaries*

Dodd-Frank ends preemption for bank operating subsidiaries by reversing *Watters v. Wachovia Bank*[20] and the regulation *Watters* upheld. Effective July 21, 2011, mortgage subsidiaries and other subsidiaries of national banks and federal thrifts will no longer be able to ignore state law.[21] Current preemption regulations will continue to apply to contracts entered into on or before July 21, 2010.[22] It is possible, however, that banks will minimize the effect of this amendment by absorbing the operations of some subsidiaries directly into the bank.

B. *Weaker Preemption of Specific State Laws*

Dodd-Frank makes several changes to the National Bank Act (NBA) and the Home Owners Loan Act (HOLA) to weaken the ability of those Acts and regulations issued under them to preempt state laws. The new preemption standard applies to "state consumer financial law," defined as any 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."[23] For example, a law governing mortgage terms is a state consumer financial law, but a general contract law is not.

The new preemption standard is a reaction to regulations issued by the Office of the Comptroller of the Currency and Office of Thrift Supervision wiping out entire areas of state consumer protection laws, including state laws governing lending, deposit taking, and the business of banking.[24] (Dodd-Frank does not change the standard of preemption for federal credit unions, but the National Credit Union Administration has been less aggressive in this area, and will likely be influenced by these changes.)

Together, various provisions of Dodd-Frank are a direct attack on the OCC and OTS preemption regulations and should add up to a repeal of those regulations:

- NBA and HOLA **do "not occupy the field** in any area of State law."[25] Current OTS regulations under HOLA directly claim to occupy the field,[26] and the OCC's NBA regulations are equally broad and have nearly the same result.[27]

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[20] 550 U.S. 1 (2007).
[21] Dodd-Frank §§ 1044, 1046. Preemption never applied to federal credit union subsidiaries.
[22] *Id.* § 1043.
[23] Dodd-Frank § 1044. to be codified at Revised Stat. § 5136C(a)(2) (NBA); *see* Dodd-Frank § 1046, to be codified at 12 U.S.C. § 1465 (HOLA, incorporating NBA standard).
[24] *See generally* NCLC, The Cost of Credit §§ 3.4.6, 3.5.3, 3.5.4 (4th ed. 2009 and Supp.).
[25] Dodd-Frank § 1044, to be codified at Revised Stat. § 5136C(b)(4) (NBA); *see* Dodd-Frank § 1046, to be codified at 12 U.S.C. § 1465 (HOLA, incorporating NBA standard).
[26] 15 C.F. R. § 560.2.
[27] *See generally* NCLC, The Cost of Credit § 3.4.6.3 (4th ed. 2009 and Supp.).

- OCC[28] can preempt "**only 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."[29] This is a reversal of the presumption under the current OCC regulations that a state law is preempted unless it has an "incidental" effect on banks. Congress also rejected efforts to weaken the *Barnett* standard by adding language from the OCC regulations permitting preemption of state laws that merely "obstruct, impair or condition" bank operations.[30]

- OCC can preempt only on a **case-by-case basis**, if a particular state law, or one with substantially equivalent terms, meets the *Barnett* standard.[31] The current regulations, in contrast, preempt broad categories of laws.

- OCC regulations or orders can preempt **only if "substantial evidence**" supports its finding that the *Barnett* standard has been met.[32] The OCC cannot merely assert interference, as it has in the past.

- Courts considering challenges to OCC regulations cannot use the deferential *Chevron*[33] standard (which has led some courts to rubber stamp OCC regulations) but instead the **less deferential *Skidmore*[34] standard**: "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."[35]

The *Barnett* standard should be interpreted as a rollback to 1996 when the *Barnett* case was decided**, before** the OTS and OCC preemption regulations and activities began, a time when few state laws were preempted.[36] The state law at issue in the *Barnett* itself (which the Supreme Court found preempted) presented a clear case of conflict preemption: state law prohibited national banks from engaging in an activity—acting as an insurance agent in towns of less than 5,000—that federal law specifically authorized them to do. In contrast, state laws that merely regulate abusive bank conduct and do not prohibit activities explicitly permitted under federal law, or interfere so significantly that they effectively prohibit the activities, should survive under the *Barnett* standard.

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[28] Dodd-Frank eliminates the Office of Thrift Supervision. The OCC will regulate both national banks and federal savings associations and will administer both the NBA and HOLA.

[29] Dodd-Frank § 1044, to be codified at Revised Stat. § 5136C(b)(1)(B). In addition, state laws are preempted if they have a discriminatory effect on national banks or federal thrifts compared to state-chartered banks, or if another provision of federal law preempts the state law.

[30] 12 C.F.R. §§ 7.4007(b), 7.4008(d), 7.4009(b), 34.4(a). For example, Congress did not adopt an amendment by Rep. Bean that would have preempted a state law that "impairs, or hampers" the business of banking. Amendment 141 to H.R. 4173 at 6 (Offered by Mrs. Bean Dec. 9, 2009).

[31] Dodd-Frank, § 1044, to be codified at Revised Stat. § 5136C((b)(1)(B), (b)(3).

[32] Dodd-Frank § 1044, to be codified at Revised Stat. § 5136C(c).

[33] Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

[34] Skidmore v. Swift & Co., 323 U.S. 134 (1944).

[35] Dodd-Frank, § 1044.

[36] *See* Lauren Saunders, National Consumer Law Center, Restore The States' Traditional Role As "First Responder" (Sept. 2009), available at http://www.nclc.org/images/pdf/preemption/restore-the-role-of-states-2009.pdf.

The OCC has claimed that its broad preemption regulations follow the *Barnett* standard. This is disingenuous, because the preemption regulations were highly controversial at the time precisely because the elimination of state law protections was a dramatic change.[37] It is likely that the OCC will amend its regulations in response to the Dodd-Frank changes, though whether the new regulations will differ in substance from the current ones remains to be seen.

The two Supreme Court National Bank Act preemption cases since 1996 do not shed much light on what state laws would withstand the *Barnett* test. *Watters*, discussed above, involved state power to license and supervise nonbank mortgage lenders, a power that is clearly beyond their reach as to national banks themselves. *Cuomo v. Clearing House Association*[38] involved the power to enforce state fair lending laws that were clearly not preempted. Lower courts have varied in their interpretations of *Barnett*, and the precise scope of the *Barnett* standard will likely be a matter of debate for some time.

The NBA and HOLA amendments go into effect on July 21, 2011. Contracts entered into on or before July 21, 2010 are grandfathered and continue to enjoy preemption.[39] However, the section heading of the new NBA and HOLA preemption provision states that the statutes are "clarified," so it is possible that Dodd-Frank could influence interpretations of those statutes and regulations under them even before the new preemption provisions are directly effective. Outright attacks on the current preemption regulations, however, are less likely to succeed for contracts that are covered by the grandfather clause.

C. ***Little Preemption of General State Laws***

The preemption provisions discussed above apply only to specific consumer protection laws, such as those regulating mortgages. The Dodd-Frank Act, the NBA and HOLA are silent on preemption of general state laws, like those against unfair or deceptive practices or contract or other common laws.

This silence should be interpreted as a rule against preemption of general state laws unless they conflict with federal law under standard Supremacy Clause principles. Even the OCC and the OTS, at the height of their preemption activities, carved out general state laws from preemption. The new NBA and HOLA amendments delineate precisely where the OCC can preempt, under strict limits, and give the agency no authority to preempt general laws. To interpret the silence in the opposite direction – giving the OCC free range to preempt general state laws that have never been subject to preemption – makes no sense.

[37] *See generally* Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System*, 23 ANN. REV. BANKING & FIN. L. 225 (2004).
[38] 129 S. Ct. 2710 (2009).
[39] Dodd-Frank, § 1043.

The OCC and OTS regulations do not address state laws against unfair or deceptive acts or practices – neither listing them among laws that are preempted nor among the general laws that are not. Courts have generally not found UDAP laws to be preempted, but decisions vary court to court and depend on how the law is applied.[40]

With respect to the NBA and HOLA preemption standards, however, UDAP laws clearly fall into the camp of the general laws that should be outside the OCC's preemption power. A UDAP law is not one 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."[41]

Even if the new preemption standard did apply to UDAP laws, it would be hard to argue that they significantly interfere with bank powers, given that they duplicate prohibitions in the federal law.

D. *Interest Rate Exportation Codified*

The Dodd-Frank Act does not change interest rate exportation. The Act effectively codifies the *Marquette*[42] and *Smiley*[43] decisions through a provision on "Preservation of Powers Related to Charging of Interest," which specifically carves out those powers from the new preemption provision.[44] Federally chartered banks, thrifts and credit unions may continue to charge interest rates and fees authorized by their home states. Banks that locate in states without usury caps are still immune from other states' usury caps even when lending to consumers in those other states.

E. *AMTPA Mortgage Preemption (Banks and Nonbanks) Largely Repealed*

Effective July 21, 2011, for contracts entered into on or after that date, Dodd-Frank all but repeals the Alternative Mortgage Transactions Parity Act (AMPTA), which currently preempts many state laws that would otherwise regulate terms such as negative amortization, balloon payments, and other terms of adjustable rate mortgages (ARMs).[45] AMTPA currently limits state regulation of those terms as to <u>any</u> mortgage lender, including nonbank state mortgage lenders. Even after the effective date of the amendment, however, laws and regulations besides AMTPA, discussed above, will still preempt some state mortgage laws as to *federally* chartered banks, thrifts and credit unions.

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[40] *See generally* NCLC, Unfair and Deceptive Acts and Practices §§ 2.5.3.2, 2.5.3.3 (7th ed. 2008 and Supp.).
[41] Dodd-Frank § 1044. to be codified at Revised Stat. § 5136C(a)(2).
[42] Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978) (banks may lend at the interest rate permitted by their home state).
[43] Smiley v. Citibank, N.A., 517 U.S. 735 (1996) (upholding regulation defining long list of fees as "interest" subject to interest rate exportation).
[44] Dodd-Frank § 1044(a).
[45] 12 U.S.C. § 3802.

The only surviving part of AMTPA is a ban on state laws that *prohibit* adjustable rate mortgages. This ban does not include a state law "that regulates mortgage transactions generally, including any restriction on prepayment penalties or late charges."[46]

F. CFPB Rules Do Not Preempt

CFPB rules will not preempt state laws unless the state laws conflict with CFPB rules.[47] This is the same preemption standard applicable to TILA and other federal consumer protections statutes.

G. States Can Enforce Nonpreempted State Laws against Banks

The Dodd-Frank Act codifies *Cuomo v. Clearing House Association*,[48] which holds that states can enforce non-preempted state laws (like fair lending laws) against national banks and federal thrifts, but cannot issue pre-litigation subpoenas to those banks or thrifts in order to investigate potential violations.[49]

III. Conclusion

The Dodd-Frank Act reinforces our vital system of federalism by reaffirming the critical role that states play in consumer protection. States have won important new powers to ensure that everyone complies with rules against unfair, deceptive and abusive conduct and new mortgage protections. States have regained their ability to regulate nonbank mortgage operations and other nonbank entities, regardless whether the lender is a bank subsidiary. In the banking world, states should also be able to play their traditional role as first responders if abuses emerge that are not yet addressed by or fall in a gap in federal consumer protection rules. Though bank regulators retain some power to preempt state law, hopefully they will use that power sparingly and will embrace the states' role as partners in protecting the nation's consumers.

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[46] Dodd-Frank § 1083, to be codified at 12 U.S.C. §§ 3802, 3803. Under current law, state laws regulating prepayment penalties and late charges are not preempted in regard to non-depository state housing creditors, 12 C.F.R. §§ 560.210, 560.220, but the Dodd-Frank provision is much broader. *See* NCLC, The Cost of Credit § 3.11.2 (4th ed. 2009).
[47] Dodd-Frank § 1041(a).
[48] Dodd-Frank § 1047, to be codified at 12 U.S.C. § 1465(c).
[49] 129 S. Ct. 2710 (2009).