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Preemption for National Banks and Federal Thrifts After Dodd-Frank:

Answers to the Ten Most Asked Questions

K&L Gates published this alert prior to July 21, 2010, the date on which President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. However, this alert discusses the final version of the bill that would eventually be signed into law.

The last ten years have been a period of consistent expansion of federal preemption for national banks and federal thrifts. That period of expansion will come to a grinding halt if the Senate passes and President Obama signs the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or the “Act”), which most observers expect to happen shortly after the Senators return from recess on July 12. (For more information on the Dodd-Frank Act, see the [other alerts in the K&L Gates alert series](#).)

The Dodd-Frank Act, however, is hardly a total victory for critics of preemption. In fact, all things considered, the preemption provisions of the Dodd-Frank Act could have been much worse for national banks and federal thrifts. Still, the preemption rules are changing. National banks, federal thrifts, and the operating subsidiaries of both need to review and reconsider the extent to which they rely on federal law to preempt state laws.

This alert identifies the ten questions that clients are asking (or, in our view, should be asking) most about how the Dodd-Frank Act affects the scope of preemption under the National Bank Act (“NBA”) and the Home Owners’ Loan Act (“HOLA”), the primary two laws governing the activities of national banks and federal thrifts, respectively. These ten questions, not necessarily in the order of importance, are:

- *What is the new preemption standard for national banks and federal thrifts? (Page 2)*
- *Will national banks and federal thrifts still be able to “export” interest rate rules from the states where they are located? (Page 4)*
- *Will federal thrifts still enjoy broader preemption than national banks? (Page 5)*
- *Last year, the Supreme Court placed significant limits on state attorney general investigations of national banks. Does the Act overturn those limits? (Page 6)*
- *What role will the OCC and OTS (now a division of the OCC) have in defining the scope of preemption? (Page 8)*
- *What happens to the existing OCC and OTS preemption regulations? (Page 9)*
- *What happens to preemption for operating subsidiaries? (Page 10)*

- *How does the repeal of preemption for operating subsidiaries affect the licensing exemption that the S.A.F.E. Mortgage Licensing Act provides to employees of bank subsidiaries? (Page 10)*
- *Does the Act change the rules governing preemption for agents of national banks and federal thrifts? (Page 11)*
- *When do these changes go into effect? (Page 12)*

When reading this alert, bear in mind that the Dodd-Frank Act abolishes the OTS and transfers most of its supervisory authority over federal thrifts to the OCC. Thus, throughout this alert we refer to the OCC as the future regulator of federal thrifts.

However, there could be a period after the preemption provisions go into effect during which the OTS will still be in existence and still primarily responsible for supervising federal thrifts.¹ For more information about transfer of functions and personnel from the OTS to the OCC (and several other agencies), see the forthcoming alert in this series, which will be available at www.klgates.com/practices/ServiceDetail.aspx?service=139&view=5.

I. What is the new preemption standard for national banks and federal thrifts?

There's no short and easy answer to this question. The Act divides the universe of state laws into two categories: (1) state consumer financial laws; and (2) state laws that are not state consumer financial laws. The Act does not modify the preemption standards for the latter. It purports to "clarify" the preemption standard for the former, but it is debatable whether it changes the standard from current law.

A. Overview

After the preemption provisions go into effect (see Part X, starting on page 13), every preemption analysis under the NBA and HOLA will begin with the following question: "Is this a state consumer financial law?" That's because the new preemption standard under the NBA and HOLA that the Act establishes, and the more restrictive procedures it imposes on OCC preemption determinations, apply

only when the state law at issue is a *state consumer financial law*.

The discussion that follows first dissects the definition of *state consumer financial law*. It then describes the preemption standard that the Act establishes for these state laws.

B. Definition of State Consumer Financial Law

Section 1044 of the Dodd-Frank Act adds a provision to the NBA which defines *state consumer financial law* as "a State law that does not directly or indirectly discriminate against national banks and 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." As discussed in Part III, the Dodd-Frank Act also incorporates this definition and the related preemption provisions into HOLA.

Thus, aside from the requirement that the law not discriminate against national banks, a state law must meet several requirements to be a *state consumer financial law* under the NBA or HOLA:

- It must regulate the manner, content, or terms and conditions of a financial transaction or account;
- It must do so "directly and specifically"; and
- The financial transaction or account that the law regulates must be "with respect to a consumer."

This definition of *state consumer financial law* is not as broad as it could have been. For example, arguments could be made that none of the following types of consumer laws qualify as state consumer financial laws:

- **Licensing Requirements:** A requirement that a company obtain a license before engaging in a financial transaction arguably does not regulate the *manner* of the transaction; it does not regulate the *content* of the transaction; and it does not regulate the *terms and conditions* of those transactions. Of course, some state laws that impose licensing requirements also impose substantive requirements (which might apply only to licensees, or might apply more broadly).

Whether these substantive requirements survive if the provisions that require a license are preempted is a separate question that generally will be governed by the applicable state's rules on severability of invalid provisions in laws (assuming that the requirements are not themselves preempted under the applicable standard).

- **UDAP Laws:** Laws that broadly prohibit unfair and deceptive business practices (“UDAP laws”) have become a favorite tool of state attorneys general and plaintiffs’ attorneys to impose *ex post facto* rules on lenders, servicers, and other providers of financial services to consumers. We would argue that these UDAP laws do not “specifically and directly” regulate financial transactions or accounts, and therefore are not state consumer financial laws.
- **Advertising Rules:** Rules on advertising arguably do not regulate the manner of a financial transaction, nor do they regulate the content or terms of a financial transaction. Rather, advertising rules regulate the manner by which a financial institution may communicate its products and services to the public.

The important takeaway from the arguments above is that the new preemption rules are not going to govern with respect to every state law that regulates consumer financial transactions. The term *state consumer financial law* likely will not cover every state law designed to protect consumers in connection with financial transactions.

C. The Standard

The NBA (as amended by Section 1044 of the Dodd-Frank Act) and HOLA (as amended by Section 1046 of the Act), respectively, will preempt a state consumer financial law only in the following two circumstances:

- (1) “application of a State consumer financial law would have a discriminatory effect on national banks [or, with respect to HOLA, federal thrifts], in comparison with the effect of the law on a bank chartered by that State;” or

- (2) “in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in” *Barnett Bank of Marion County, N. A. v. Nelson*, 517 U.S. 25 (1996), “the State consumer financial law prevents or significantly interferes with the exercise by the national bank [or federal thrift] of its powers[.]”

The preemption provisions also clarify that they only limit the extent to which the NBA or HOLA preempts state consumer financial laws. A state consumer financial law still will be preempted for a national bank or federal thrift if the “State consumer financial law is preempted by a provision of Federal law other than” the NBA or HOLA.

Since very few state laws discriminate against national banks, the dispositive question for most preemption analyses involving state consumer financial laws will be *whether, in accordance with the Barnett decision, the state consumer financial law prevents or significantly interferes with the exercise by a national bank or federal thrift of its powers.*

D. Impact

Since 2004, most preemption analyses for national banks revolved around the proper interpretation of the OCC’s preemption rules; *Barnett* and court decisions interpreting *Barnett* were an afterthought, if they were considered at all. *Barnett* also rarely factored into a preemption analysis for federal thrifts, which would focus primarily on preemption rules that the OTS adopted in 1996. Lawyers for national banks and federal thrifts must now become intimately familiar with the case law interpreting *Barnett*.

This body of case law is substantial. On July 2, 2010, the Shepherd’s report for *Barnett* identified 277 court decisions that used the word *preemption* or a derivation thereof. These included four Supreme Court decisions, 55 decisions by the federal courts of appeals, 118 decisions by federal district or bankruptcy courts, and 34 decisions by state supreme courts.

No one should be surprised to learn that national banks did not have a 277-0 record in the case law interpreting and applying *Barnett*. But, on balance, the case law is quite good for national banks.

Courts, including the Supreme Court, generally concluded that a state law does not need to wreak too great an interference with a national bank's ability to exercise its powers before the state law will be preempted under the *Barnett* standard. Our initial survey of the *Barnett* case law reveals that courts have interpreted *Barnett* to leave little room for state regulation of national bank activities.

Part of the reason for this is that courts usually define the national bank "power" at stake fairly granularly—and the more narrowly the power at stake is defined, the broader the preemption. For example, if one says that the ability to charge a fee for a service (such as providing cash at an ATM) is itself a discrete power of a national bank (as the Ninth Circuit Court of Appeals concluded in a 2001 decision), then any state law that prohibits ATM fees "prevents . . . the exercise by the national bank" of a power.

There is nothing in the Dodd-Frank Act that would suggest courts should understand the term "power" differently when courts are applying the *Barnett* standard via the statutory preemption provision for state consumer financial laws. Indeed, the opening clause ("in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in" *Barnett*) would suggest that courts should not interpret the preemption standard in the statute any differently than they interpreted the preemption standard in *Barnett* itself.

Remember also that the preemption standard in the Dodd-Frank Act applies only to *state consumer financial laws*, which does not include many state laws that regulate financial transactions with consumers. Presumably, the existing preemption standards under the NBA will continue to apply to state laws that are not *state consumer financial laws*.

II. Will national banks and federal thrifts still be able to "export" interest rate rules from the states where they are located?

Very little of the information in this alert could be considered good news for national banks and federal thrifts, except perhaps in comparison to what the news could have been. But the provision of the Act

that deals with interest exportation qualifies as *bona fide* good news: The Act expressly provides that no provision of the NBA "shall be construed as altering or otherwise affecting the authority conferred by [12 U.S.C. § 85] for the charging of interest by a national bank at the rate allowed by the laws of the State, territory, or district where the bank is located, including with respect to the meaning of 'interest' under such provision." The Act also amends HOLA to incorporate the preemption standards under the NBA, which presumably would include the limits in the foregoing provision on the extent to which these new legal standards affect the interest exportation statutes.

Interest exportation is the term commonly used to describe the ability of most banks to charge interest at the rate allowed by the laws of the states where they are located, even when making loans to borrowers in other states. (It is also sometimes called "most favored lender authority.") Section 30 of the NBA (codified at 12 U.S.C. § 85, and thus more commonly known as "Section 85") has authorized a national bank to charge interest at the rate allowed by the laws of the state where the bank is located since 1864. The comparable provision for federal thrifts is in Section 4 of HOLA.

The OCC and OTS have issued identical rules to implement the interest exportation provisions of the NBA and HOLA. These rules define "interest," for purposes of Section 85, as "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended."² According to the regulation itself, this broad definition encompasses, among other types of fees, the numerical periodic rate; late fees; NSF fees; overlimit fees; annual fees; and cash advance fees. Thus, a bank exercising its interest exportation authority may follow the laws of its location state for all of these fees, and restrictions on these fees under the laws of the borrower's state will be preempted. The broad definition of *interest* in the rules appears to be what the Dodd-Frank Act is referring to when it says "including with respect to the meaning of 'interest' under such provision."

That the Dodd-Frank Act preserves interest exportation authority for national banks and federal

thrifts should be an enormous relief to them. Without interest exportation, it would be nearly impossible to offer credit cards in some states except to the most creditworthy sliver of consumers. Other types of lending also would be made significantly more difficult. States impose complex and inconsistent rules about how lenders may allocate the finance charges among different fees. Most of these laws are not unduly difficult to follow when they are viewed in isolation, but it can be burdensome for a lender operating in more than one state to adapt the fee structures on its products to the peculiarities of individual state laws.

The Act's provision on interest exportation would appear to trump the provisions (discussed above, starting on page 2) that establish a new preemption standard for state consumer financial laws. Even if the interest restrictions in the borrower's state qualified as state consumer financial laws, they could still be preempted in accordance with the interest exportation provisions, without regard to whether the otherwise applicable preemption standard for state consumer financial laws, described above, is met.

III. Will federal thrifts still enjoy broader preemption than national banks?

As a general rule, no. The Act amends HOLA to provide, in essence, that HOLA preempts state laws for federal thrifts to the same extent that the NBA preempts state laws for national banks. The Act also adds a new provision to HOLA which provides that the visitorial powers provision in the NBA "shall apply to Federal savings associations, and any subsidiary thereof, to the same extent and in the same manner as if such savings associations, or subsidiaries thereof, were national banks or subsidiaries of national banks, respectively."

A. Background

Although the gap narrowed substantially in recent years, preemption for federal thrifts historically was broader than for national banks. Much of this gap came from the fact that it has been clear since a 1982 Supreme Court decision that the OTS and its predecessor agency, the Federal Home Loan Bank Board ("FHLBB"), had the authority to issue rules that preempt state laws for federal thrifts.³ Armed

with this authority, the OTS issued a rule in 1996 that "occupied the field" of federal thrift lending regulation. This meant that federal thrifts were not required to comply with any state laws that regulated lending, except with respect to a few discrete subjects identified in the OTS rule and other federal laws.

The OCC proceeded much more cautiously than the OTS on preemption matters. The OCC did not issue a set of preemption rules comparable to the OTS's 1996 rules until 2004. Even the 2004 rules refrained from "occupying the field" of national bank lending regulation, although they arguably established a preemption regime that was, for all practical purposes, just as broad as under the OTS's rules.

B. Impact of the Act

As mentioned above, the Dodd-Frank Act would amend HOLA to provide that the preemption standards under the NBA govern preemption under HOLA. A separate provision also explains that the visitorial powers limits in the NBA apply to federal thrifts. These two provisions should eliminate any remaining vestiges of the preemption gap.

Federal thrifts were for the most part on the good side of the preemption gap, so ending it may seem like a modest net negative for them. But there are at least two crucial ways in which the preemption equivalence clearly benefits federal thrifts. First, it recognizes explicitly that federal thrifts are not subject to "visitorial powers" by the states. Second, the Dodd-Frank Act amendments to HOLA arguably extend to federal thrifts the holding in *Beneficial National Bank v. Anderson*, which said that the interest exportation provisions for national banks "completely preempted" state usury laws, allowing any lawsuits against a national bank for violating state restrictions on "interest" charges to be removed to federal court.

1. Visitorial Powers

The NBA has always expressly provided that national banks are not subject to visitorial powers except as authorized by federal law. The exact meaning of the term *visitorial powers* has been the subject of dispute. Still, no one seriously doubts that it includes the authority to conduct routine

examinations of national banks and to enforce their compliance with applicable law through an administrative process. Since federal law authorizes state officials to exercise visitorial powers over national banks only with respect to a few discrete subjects, this limit on visitorial powers severely limits the ability of state officials to supervise national banks or enforce national banks' compliance with state or federal laws.

The OTS has always taken the position that states also may not examine federal thrifts or bring enforcement actions against them. Unlike with national banks, however, there was no statute that expressly limited the supervisory authority of states over federal thrifts. Not that this meant federal thrifts were actually subject to supervision by states. For example, in the Ninth Circuit decision *Conference of Federal Savings & Loan Associations v. Stein*,⁴ which was summarily affirmed by the Supreme Court,⁵ the court explained that the "broad regulatory authority over the federal associations conferred upon the [FHLBB] by HOLA does wholly pre-empt the field of regulatory control over these associations."⁶ "If state-conferred rights are to be enforced against the federal associations by any regulatory body," the court said, "enforcement must be by the [FHLBB]."⁷ The Dodd-Frank Act basically codifies this holding. This should eliminate the possibility that states might have pointed to the absence of a visitorial powers provision in HOLA as giving states greater supervisory authority over federal thrifts than national banks.

2. Complete Preemption

Establishing explicitly that preemption for federal thrifts is identical to preemption for national banks also should mean that the interest exportation provision in HOLA "completely preempts" state laws that purport to regulate interest fees.

Normally, a federal district court will not have federal question jurisdiction over a matter if the complaint alleges only causes of action under state law. This is true even if the defendant is likely to plead a defense based on federal law—such as the defense that federal law preempts the state law causes of action in the complaint. When the complaint alleges only state law causes of action, the defendant can remove the case to federal court only

if the case falls under the court's diversity jurisdiction.

An exception to the foregoing general rules is the so-called "complete preemption" doctrine. The Supreme Court has held that a handful of federal statutes preempt state laws on a subject so completely that there is no state cause of action with respect to the subject. If a plaintiff asserts claims under a state law preempted by one of these federal statutes, then the defendant may remove the case to federal court, even if the complaint does not mention federal law.

In *Beneficial*, the Supreme Court held that the interest exportation provision in the NBA "completely preempted" for national banks state laws that regulated interest.⁸ Courts have not addressed whether the same rule applies for the interest exportation provision in HOLA. An argument could be made that it does, since the interest exportation provision in HOLA was modeled on the interest exportation provision in the NBA.

However, courts have split over the merits of this argument with respect to another provision modeled on Section 85 of the NBA—Section 521 of DIDMCA, which provides interest exportation authority to state-chartered banks with federal deposit insurance.⁹ The Dodd-Frank Act should lay to rest any questions about whether the interest exportation provisions of HOLA completely preempt for federal thrifts under state laws that regulate interest.

IV. Last year, the Supreme Court placed significant limits on state attorney general investigations of national banks. Does the Act overturn those limits?

No. The Dodd-Frank Act does not appear to overturn the limits on state attorney general investigations of national banks that the Supreme Court established in *Cuomo v. Clearing House Association*.

A. Background

The NBA bars state officials, including state attorneys general, from exercising “visitorial powers” over national banks (subject to limited exceptions). In *Cuomo v. Clearing House Association*, the Supreme Court held that the OCC went too far when it issued a rule that defined the term “visitorial powers” to include suing a national bank to enforce state law.

Because the Supreme Court partially invalidated a rule that had protected national banks, the headlines after *Cuomo* was decided reported the decision as a loss for national banks and the OCC. But while the *Cuomo* decision was far from an unequivocal victory for national banks, the Court did affirm that there are significant limitations on the ability of a state attorney general to launch investigations of national banks.

The *Cuomo* decision distinguished between the exercise of *visitorial powers* and what the decision called “ordinary law enforcement.” *Visitorial powers*, the Court said, included “any form of administrative oversight that allows [the government] to inspect books and records on demand, even if the process is mediated by a court[.]” According to the Court, a state attorney general who brings a lawsuit against a national bank is engaged in mere *ordinary law enforcement*.

Applying this distinction to the facts before it, the Court concluded that Attorney General Cuomo was not barred from bringing a civil suit against a national bank to enforce state law, or even from obtaining a judicial search warrant.¹⁰ However, New York law authorizes the Attorney General to issue subpoenas without going to court, and the *Cuomo* litigation arose in response to a threat from the Attorney General to issue such subpoenas against national banks if they did not comply with a request for voluntary disclosure of information.¹¹ The Court held that issuance of extra-judicial subpoenas by a state attorney general did constitute the kind of visitorial powers that the NBA prohibited states from exercising over national banks. Consequently, the Court allowed to stand the district court’s injunction against the Attorney General issuing subpoenas against national banks.

Not being able to subpoena information at will from national banks is a huge limit on the powers of attorneys general. Attorney General Cuomo’s *modus operandi* is not to bring a lawsuit and then slog through the civil discovery process. Why should it be? New York law allows Attorney General Cuomo to issue broad subpoenas without going to court. However, the *Cuomo* decision says that when the target of an investigation is a national bank, going to court and dealing with discovery procedures is exactly what Attorney General Cuomo must do.

B. Provisions of the Act Dealing With *Cuomo*

Section 1047 of the Dodd-Frank Act amends the NBA to provide that in “accordance with the decision of the Supreme Court of the United States in” *Cuomo v. Clearing House Ass’n, LLC*, 129 S. Ct. 2710 (2009), “no provision of [the NBA] which relates to visitorial powers or otherwise limits or restricts the visitorial authority to which any national bank is subject shall be construed as limiting or restricting the authority of any attorney general (or other chief law enforcement officer) of any State to bring an action against a national bank in a court of appropriate jurisdiction to enforce an applicable law and to seek relief as authorized by such law.”

This provision should mean that state attorneys general will continue to be subject to the limits on their investigatory powers described in *Cuomo*. Further, as explained above beginning on page 7, Section 1047 of the Act also extends the visitorial powers provisions in the NBA to federal thrifts. Thus, the limits established by *Cuomo* should apply to attorney general investigations of federal thrifts.

For more information on the role of state attorneys general in the Dodd-Frank Act’s enforcement regime, see the K&L Gates alert entitled *Consumer Financial Services Industry, Meet Your New Regulator*, by Melanie H. Brody and Stephanie C. Robinson (available at www.klgates.com/newsstand/Detail.aspx?publication=6527.)

V. What role will the OCC and OTS (now a division of the OCC) have in defining the scope of preemption?

The OCC and OTS (now a division within the former, but still separately responsible for addressing preemption issues for federal thrifts) will not be permitted to issue broad preemption rules for state consumer financial laws; the agencies will be allowed to determine that such laws are preempted only on a “case-by-case basis.” The Act also instructs courts to scrutinize these preemption determinations more carefully than courts do currently.

A. Background

In recent years, the banking agencies have played a major role in defining the scope of federal preemption for national banks and federal thrifts. As discussed above on page 5, the Supreme Court held in 1982 that the OTS’s predecessor had broad authority to issue rules that preempted state laws for federal thrifts. Since 1996, OTS rules occupied the field of federal thrift lending and deposit-taking, which meant that state laws generally did not apply to the lending or deposit-taking activities of federal thrifts (subject to a few exceptions). Since 1996, most court decisions addressing preemption for federal thrifts have started and ended by interpreting and applying these rules. When states began enacting draconian anti-predatory lending laws in the beginning of the decade, the OTS was at the forefront of declaring these laws to be preempted for federal thrifts through a series of legal opinions. The OTS also established the groundwork for preemption for agents of federal thrifts in its State Farm Letter.

As is also explained above, the OCC has historically been less assertive about defining the scope of preemption for national banks. For over 140 years after the NBA was enacted in 1864, the OCC was largely content to let courts define through case law the extent to which the NBA preempted state laws. Although there were exceptions, OCC preemption rules tended to be reactive, codifying preemption rules only after they had become well established by case law.

In 2003, the OCC decided to flex some more muscle. It issued a preemption determination and

order that declared almost all the provisions of Georgia’s anti-predatory lending law to be preempted for national banks and their operating subsidiaries. At the same time, the OCC proposed rules modeled on the OTS’s broad preemption rules (although the OCC proposal fell short of explicitly occupying the field of national bank lending regulation). The agency finalized these rules early in 2004.

State officials and consumers have at various times challenged the validity of these agency rules, but courts have mostly sided with the agencies (the most notable recent exception being the *Cuomo* decision discussed above). As a result, preemption today is in no small part a creation of the OCC and OTS.

B. No More Broad Preemption Regulations for Consumer Financial Protection Laws

As discussed above beginning on page 2, the Act distinguishes for preemption purposes between *state consumer financial laws* and all other state laws. The OCC may issue a determination that a state consumer financial law “prevents or significantly interferes with a national bank’s exercise of its powers only on a “case-by-case basis.” The Act defines *case-by-case basis* to mean “a determination . . . made by the [OCC] concerning the impact of a particular State consumer financial law on any national bank that is subject to that law, or the law of any other State with substantively equivalent terms.” This rule appears to prohibit the OCC from issuing rules that declare entire broad categories of state consumer financial laws to be preempted.

Note that the requirement that preemption determinations be made on a “case-by-case basis” applies only with respect to state laws that qualify as *state consumer financial laws*. No provision of the Dodd-Frank Act purports to limit the OCC’s authority to enact broad preemptive rules for state laws that do not qualify as *state consumer financial laws*.

The amendments by the Dodd-Frank Act do not address one way or another whether the OCC must follow the notice-and-comment rules under the Administrative Procedure Act when issuing preemption determinations.

C. Potentially Greater Judicial Scrutiny of Agency Preemption Determinations

In most instances, courts decide whether to defer to an agency rule (and some other types of formal agency issuances) using the standard set forth in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*¹² (“*Chevron*”). Under *Chevron*, a court will first ask whether the statute that the agency rule or issuance purports to implement clearly addresses the issue presented in the case. If it does, there is no need for any further analysis—the court will apply the rule set forth in the statute. If the statute is silent or ambiguous with respect to the specific question, then the court will ask whether the agency rule or issuance represents a “permissible construction of the statute.” If so, the court will defer to the agency. If not, then the court will ignore the agency’s position and use other tools of statutory interpretation to resolve the ambiguity.

The Dodd-Frank Act amends the NBA to supply the standard of review that courts should use when assessing the validity of an OCC preemption determination. A court reviewing an OCC preemption determination should consider the following factors:

- 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.

VI. What happens to the existing OCC and OTS preemption regulations?

The Act does not expressly address how its provisions affect the existing OCC and OTS preemption rules. Arguably, the OCC rules survive for laws that are not state consumer financial laws, but their vitality with respect to state consumer financial laws is less clear. The OTS rules probably will not fare as well, although it would appear that the rules in any OCC rules that survive with respect to national banks now would apply to federal thrifts.

A. OCC Rules

As noted in various places above, the OCC issued comprehensive preemption rules in 2004. These rules provide that any state law that “obstructs, impairs, or conditions” a national bank’s ability to exercise its federally-authorized lending or deposit-taking powers was preempted. The rules then identified specific types of state laws that were preempted under these standards.

The Dodd-Frank Act does not specifically repeal these rules. Moreover, the Dodd-Frank Act addresses only the specific preemption standard for “state consumer financial laws.” Arguably, preemption of any state law that is not a state consumer financial law is governed by the same law that applied before the Dodd-Frank Act—which would include the OCC’s 2004 preemption rules. (This assumes, of course, that the OCC does not repeal or alter these rules as part of the regulatory review and overhaul that it will probably need to perform as a result of the Act.)

A decent argument also could be made that courts should continue to apply the OCC rules in cases involving state consumer financial laws, or at least treat the rules as persuasive authority. The preamble to these rules carefully and persuasively described the legal foundation upon which they were based. The OCC explained that it intended these rules not to create new law, but to be a codification of the preemption standards laid down by the Supreme Court in the preceding 140 years, including *Barnett*:

We have adopted in this final rule a statement of preemption principles that is consistent with the various formulations [in Supreme Court decisions] noted earlier. The phrasing used in the final rule—obstruct, impair, or condition—. . . [is] drawn directly from applicable Supreme Court precedents[.] The OCC intends this phrase as the distillation of the various preemption constructs articulated by the Supreme Court, as recognized in *Hines* and *Barnett*, and not as a replacement construct that is in any way inconsistent with those standards.¹³

Since the OCC rules purport to apply *Barnett* and the holdings of other Supreme Court decisions upon which *Barnett* itself relied, the list of preempted

state laws in the rules represent the agency's assessment that the listed laws prevent or significantly interfere with a national bank's powers within the meaning of *Barnett*.

B. OTS Rules

As discussed above, the primary OTS rule that preempts state lending laws for federal thrifts "occupies the field" of federal thrift lending regulation. This means that federal thrift lending activities are not subject to any state laws, except in a few areas specifically identified by the rules or other federal laws. Like other OTS rules governing federal thrifts, the preemption rule is not automatically repealed by the abolition of the OTS and the transfer of its authority over federal thrifts to the OCC.

Unfortunately for fans of this rule, the Dodd-Frank Act amends HOLA to expressly provide that HOLA "does not occupy the field in any area of State law." Since the OTS preemption rules purport to implement HOLA, and the agency derives its authority to enact those rules from HOLA, this amendment would appear to pull the foundation out from under the OTS's preemption rules. All is not lost for federal thrifts, however. As noted in the discussion of the preemption gap on pages 5 to 8, the laws and legal standards that govern preemption of state law by the NBA for national banks also govern the preemption of state law by HOLA for federal thrifts. If the OCC rules still have any vitality—and, as discussed above, there is good reason to believe that they will, unless the OCC repeals them—then the preemption principles established by those rules should govern preemption under HOLA also. The OCC rules do not explicitly "occupy the field," but they do preempt broad swaths of state laws.

VII. What happens to preemption for operating subsidiaries?

In *Watters v. Wachovia Bank, N.A.*, the Supreme Court held that the NBA preempted a Michigan mortgage lender registration law for operating subsidiaries ("op subs") of national banks. The sweeping reasoning of the decision suggested strongly that the Court would also hold, in an appropriate case, that the NBA preempted for op

subs any substantive state laws (e.g., restrictions on loan terms or practices) that the NBA preempts for national banks.

The Dodd-Frank Act provides that no provision of the NBA will preempt the application of any state law to a subsidiary or affiliate of a national bank (unless the subsidiary or affiliate is itself a national bank). As explained above, an amendment to HOLA will provide that preemption under HOLA is governed by "the laws and legal standards applicable to national banks regarding the preemption of State law."

As a result of these provisions, national banks and federal thrifts have basically two options for their op subs. One is to merge the operating subsidiaries into the parent. The other option is to bring the op subs into compliance with state law, which could include obtaining a number of state licenses (depending on the specific activities in which the op subs engage). Note, however, that many states provide exemptions from licensing requirements (and other laws regulating financial transactions) for subsidiaries or affiliates of depository institutions. The repeal of preemption for op subs would not affect their ability to rely on any exemptions granted to them by state law.

VIII. How does the repeal of preemption for operating subsidiaries affect the licensing exemption that the S.A.F.E. Mortgage Licensing Act provides to employees of bank subsidiaries?

The repeal of preemption for op subs does not change the exemption in the S.A.F.E. Mortgage Licensing Act (the "SAFE Act") for loan originators employed by bank subsidiaries. However, it does mean that states now have the power to go beyond the federal floor and impose a licensing requirement on these loan originators.

The SAFE Act, which became law in 2008, essentially requires every "loan originator"¹⁴ to be licensed under state law (subject to provisions for licensure by HUD of loan originators operating in states with licensing regimes that do not meet

certain standards), unless the loan originator is an employee of:

- A depository institution;¹⁵
- A subsidiary of a depository institution that is (i) owned and controlled by a depository institution; and (ii) regulated by a federal banking agency;¹⁶ or
- An institution regulated by the Farm Credit Administration.¹⁷

The Dodd-Frank Act does not eliminate the foregoing exemption for employees of bank subsidiaries. Thus, even after the Dodd-Frank Act goes into effect, the SAFE Act itself will not require employees of op subs to obtain state loan originator licenses.

Whether state law will require these employees to obtain state loan originator licenses, however, is another matter. The SAFE Act does not expressly preempt state laws that require loan originators employed by such subsidiaries to obtain state licenses. Until now, the fact that the SAFE Act did not preempt these state requirements for employees of op subs did not matter much—the NBA and HOLA did. The repeal of preemption for op subs removes this obstacle to states requiring employees of op subs to obtain state licenses.

This does not mean that states will impose this licensing obligation, however. The model state law to implement the SAFE Act proposed by the Conference of State Bank Supervisors (“CSBS”) and the American Association of Residential Mortgage Regulators (“AARMR”) incorporated the exemption in the SAFE Act for employees of bank subsidiaries that are registered with the Nationwide Mortgage Licensing System and Registry to be established by the federal banking agencies. Most states adopted this model law without changing this exemption. However, some states removed this exemption and, thus, require loan originators employed by bank subsidiaries to obtain state licenses.

IX. Does the Act change the rules governing preemption for agents of national banks and federal thrifts?

Yes—the NBA and HOLA will no longer preempt any state laws for agents of national banks and federal thrifts, respectively, simply by virtue of their status as agents.

A. Background

In 2004, the OTS issued a letter to State Farm Bank opining that certain exclusive agents of State Farm Bank were not subject to state licensing requirements purportedly triggered by the services they provided to the bank.¹⁸ The OTS reasoned that allowing states to regulate the services that the agents provided to or on behalf of State Farm Bank—including requiring the agents to obtain state licenses as a condition of being able to perform those services—was tantamount to regulating the manner in which State Farm Bank marketed its products. The OTS’s position would be upheld by the United States District Court for the District of Connecticut and, in a separate case, by the United States Court of Appeals for the Sixth Circuit (albeit after an initial loss in the district court).

The OCC never issued a preemption determination or interpretive letter comparable to the State Farm Letter for agents of national banks. However, a number of courts have held, following reasoning that mirrors the reasoning of the OTS in the State Farm Letter, that the NBA preempts state laws for agents of national banks in some situations.¹⁹

B. Provisions of the Dodd-Frank Act

The Dodd-Frank Act adds a provision to the NBA which provides that no provision of the NBA will preempt the application of any state law to an agent of a national bank (unless the agent is itself a national bank). As explained above, a provision that the Dodd-Frank Act adds to HOLA will provide that preemption under HOLA is governed by “the laws and legal standards applicable to national banks regarding the preemption of State law.” This HOLA amendment arguably would operate to stop HOLA from preempting any state laws for federal thrifts.

X. When do these changes go into effect?

The preemption amendments go into effect on the “designated transfer date,” which is also the date that many of the consumer protection enforcement powers of the existing federal agencies are consolidated in the new Bureau of Consumer Financial Protection.

The Treasury Secretary must fix the designated transfer date within 60 days of the Act becoming law. The date cannot be sooner than six months after the Act becomes law, and (unless the Treasury Secretary submits a report to Congress explaining the reasons for the delay) not later than one year after the Act becomes law.

The process for fixing the designated transfer date is discussed in more detail in the alert in this series on the Bureau, *Consumer Financial Services Industry, Meet Your New Regulator*, by Melanie H. Brody and Stephanie C. Robinson (available at www.klgates.com/newsstand/Detail.aspx?publication=6527.)

It’s a new world for federally-chartered institutions and their operating subsidiaries, and there is not much time for these institutions to come into compliance with state laws. If you have any additional questions, or would like someone to design or perform a “preemption audit” to identify areas where you might not be able to continue to rely on preemption, please contact us.

[This client alert is part of a series of alerts focused on monitoring financial regulatory reform.](#)

¹ As discussed later in this alert, the preemption provisions will become effective sometime between six and 18 months after the Dodd-Frank Act becomes law. The OTS will be abolished and most of its authority with respect to federal thrifts transferred to the OCC on a date, to be determined by the Treasury Secretary, between 12 and 18 months after the Act becomes law. Thus, it could in theory be as long as a year between the time that the preemption provisions discussed in this alert go into effect and the time that OTS’s authority over federal thrifts is transferred to the OCC.

² 12 C.F.R. § 7.4001(a); *Id.* § 560.110.

³ *Fidelity Fed. Sav. & Loan Ass’n v. de la Cuesta*, 458 U.S. 141 (1982).

⁴ 604 F.2d 1256, 1260 (9th Cir. 1979).

⁵ 445 U.S. 921 (1980).

⁶ *Id.* Although the phrase “regulatory control” might be understood to encompass the power to prescribe substantive rules governing the activities of an institution, it appears from the context of the opinion that the court was using the phrase more narrowly to refer to the power to monitor, examine, or investigate the activities of an institution, and to bring enforcement actions for violations.

⁷ *Id.*

⁸ See *id.* (quoting *Evans*, 251 U.S. at 114 and *Farmers’ and Mechanics’ Nat. Bank v. Dearing*, 91 U.S. 29, 32-33 (1987)).

⁹ Compare *Thomas v. US Bank Nat’l Ass’n ND*, 575 F.3d 794, 797-98 (8th Cir. 2009) (“Complete preemption does not exist here because the [interest exportation provision for state-chartered banks], unlike the [interest exportation provision in the] NBA, does not reflect Congress’ intent to provide the exclusive cause of action for a usury claim against a federally-insured state-chartered bank.” Later, the court compares the interest exportation provision for state banks with the provision for federal thrifts, and suggests strongly that it would reach the same conclusion with respect to the latter provision.) with *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 294 (3rd Cir. 2005) (Section 521 should be interpreted consistent with Section 85; thus, the former should be interpreted to “completely preempt” state laws regulating interest) and *Discover Bank v. Vaden*, 489 F.3d 594, 606 (4th Cir. 2007) (reversed on other grounds in *Vaden v. Discover Bank*, 129 S. Ct. 1262 (2009)) (same).

¹⁰ *Id.*

¹¹ After the Attorney General—still Eliot Spitzer at the time—sent “letters of inquiry” to national banks that threatened subpoenas if the banks did not voluntarily turn over the information requested, the Clearing House Association (on behalf of its member banks) and the OCC filed actions in federal district court seeking an injunction barring Spitzer from issuing the threatened subpoenas or bringing an enforcement action in court against any national bank.

¹² 467 U.S. 837 (1984).

¹³ Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910 (January 13, 2004) (final rule) (footnotes omitted).

¹⁴ The SAFE Act defines “loan originator,” subject to certain exceptions, as “and individual who (1) takes a residential mortgage loan application; and (2) offers or negotiates terms of a residential mortgage loan for compensation or gain.” 12 U.S.C. § 5103(3)(A)(i).

¹⁵ *Id.* § 5103(7)(A)(i).

¹⁶ *Id.* § 5103(7)(A)(ii).

¹⁷ *Id.* § 5103(7)(A)(iii).

¹⁸ OTS Op. of Chief Counsel 2004-7 (October 25, 2004).

¹⁹ See, e.g., *Pacific Capital Bank, N.A. v. Blumenthal*, 542 F.3d 341, 353 (2nd Cir. 2008) (“If a state statute subjects non-bank entities to punishment for acting as agents for national banks with respect to a particular NBA-authorized activity and thereby significantly interferes with national banks’ ability to carry on that activity, the state statute does not escape preemption on the theory that, on its face, it regulates only non-bank entities.”); *State Farm Bank, N.A. v. Reardon*, 539 F.3d 336 (6th Cir. 2008) (federal banking laws preempt any state laws that hinder a federal thrift’s lending authority, even if

the state laws purport to apply to a party other than the thrift); *SPGGC, LLC v. Ayotte*, 488 F.3d 525 (1st Cir. 2007) (It “would be contrary to the language and intent of the National Bank Act to allow states to avoid preemption simply by enacting laws that prohibited non-bank firms from providing national banks with the resources to carry out their banking activities.”); *SPGGC, LLC v. Blumenthal*, 505 F.3d 183, 190 (2nd Cir. 2007) (preemption analysis under federal banking laws should focus “less on the identity of the plaintiff . . . than on whether and to what extent the [gift card being sold by the bank’s agent in the case] represented an exercise of” the bank’s powers under federal law).

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