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Preemption of State Law for National Banks and Their Subsidiaries by Regulations Issued by the Office of the Comptroller of the Currency: A Sketch

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February 18, 2005

Abstract. February 12, 2004, was the effective date of regulations, issued by the Office of the Comptroller of the Currency (OCC), the regulator of national banks, preempting certain types of state laws affecting national bank real estate lending, other lending, and deposit-taking functions and providing a procedure for OCC to preempt other state laws affecting activities or powers authorized by Congress for national banks. Over the years, OCCs preemptive authority has been challenged in the courts. The new regulations have been criticized by state bank regulators, mortgage bankers, and consumer groups as exceeding OCCs authority, upsetting the delicate balance of the dual banking system, and undermining states ability to enact and enforce consumer protection and anti-predatory lending laws. Although legislation was introduced in the 108th Congress to overturn the regulations, it was not acted upon.

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Summary

February 12, 2004, was the effective date of regulations, issued by the Office of the Comptroller of the Currency (OCC), the regulator of national banks, preempting certain types of state laws affecting national bank real estate lending, other lending, and deposit-taking functions and providing a procedure for OCC to preempt other state laws affecting activities or powers authorized by Congress for national banks. Over the years, OCC's preemptive authority has been challenged in the courts.[1] The new regulations have been criticized by state bank regulators, mortgage bankers, and consumer groups as exceeding OCC's authority, upsetting the delicate balance of the dual banking system, and undermining states' ability to enact and enforce consumer protection and anti-predatory lending laws. Although legislation was introduced in the 108th Congress to overturn the regulations, it was not acted upon. This report will be updated as warranted by Congressional activity.

Background

No federal statute explicitly grants OCC the power to issue preemption rules. Drawing upon its interpretation of the preemptive effect of various statutes, including the powers provisions of the National Bank Act, 12 U.S.C. § 24, and judicial formulations of preemption standards in litigation involving national banking, OCC issued regulations amending 12 C.F.R. Parts 7 and 34, to preempt certain types of state laws affecting national bank real estate lending, other lending, and deposit-taking functions.[2] The regulations also provide a procedure for OCC to preempt other state laws affecting activities or powers authorized by Congress for national banks. On the same day, OCC

[1] CRS Report RL32197, *Preemption of State Law for National Banks and Their Subsidiaries by the Office of the Comptroller of the Currency*, by M. Maureen Murphy.

[2] 69 *Fed. Reg.* 1904 (January 13, 2004).

issued another rule, 12 C.F.R. § 7.4000(a)(3), interpreting 12 U.S.C. § 484 as providing OCC exclusive "visitorial" or oversight authority over national bank activities to the exclusion of state authority — except as specifically authorized by federal law.[3] Included in the preemption regulations are prohibitions on certain types of predatory lending in connection with consumer loans offered by national banks. In promulgating the regulations, OCC expressed its commitment to take enforcement actions against national banks engaging in abusive lending practices.[4]

These regulations come in the wake of state legislative and enforcement activity to combat predatory lending and other abusive practices impacting consumers.[5] Heavily regulated financial institutions, such as national banks, have not been the primary target of state predatory lending laws. State banking regulators, however, have expressed concern that preemption of state laws by federal banking regulators may dilute consumer protections under state law. They have also criticized preemption as harmful to the dual banking system, under which every bank, whether state-chartered or federally chartered, is subject to both federal and state law, with primary regulation dependent upon the authority under which the bank is chartered. State attorneys general[6] and consumer groups have also opposed preemption of state laws by federal regulators.[7] On the other hand, banking trade associations seem to view OCC's preemption regulations as comporting with a healthy dual banking system, presumably because of the resulting sharpening of distinctions between state-chartered and national banks and the possibility of some banks electing to switch charters. Under the dual banking system, banks — either new banks or those in operation — may choose a federal or a state charter or convert from one charter to another and thereby from one primary regulator to another. The National Association of Realtors, in testimony before the House Financial Services Subcommittee on Oversight and Investigations, on January 28, 2004, sharply criticized the preemption rules as twisting legal precedent, maximizing the value of the federal bank charter at the expense of the state bank charter, and diluting consumer protections, with worsening implications if bankers are permitted to be real estate brokers and managers.[8]

The courts have been receptive to OCC's preemption efforts. The exclusivity of OCC's authority to police the credit card practices of national banks received an endorsement in a recent Rhode Island Supreme Court decision. *Chavers v. Fleet Bank,* 844 A. 2d 665 (R.I. 2004), which dismissed a state enforcement action and found national banks to be exempt from Rhode Island's Deceptive Trade Practices Act because of OCC's

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[3] 69 *Fed. Reg.* 1895 (January 13, 2004).

[4] OCC's efforts to combat predatory lending practices are highlighted on the OCC website at [http://www.occ.treas.gov/Consumer/combat.htm] (Last visited February 16, 2005).

[5] Federal predatory lending legislation proposals in the 108th Congress are treated in CRS Report RL32062, *Housing Issues in the 108th Congress*, by Bruce E. Foote, pp. 19-24.

[6] [http://www.naag.org/issues/20031006-multi-occ.php] (last visited February 16, 2005).

[7] [http://www.predatorylending.org] (last visited February 16, 2005).

[8] [http://www.realtors.org/gapublic.nsf/pages/occtestimony?OpenDocument] (last visited February 16, 2005).

regulation. In *Wells Fargo Bank, N.A. v. Boutris*,[9] a California federal district court held that OCC's visitorial powers over national banks–i.e., the power to examine and oversee national banks, which are exclusive under 12 U.S.C. § 484, also applied to an operating subsidiary of a national bank doing mortgage business in California and incorporated under California law. The state banking commissioner was, therefore, preempted from requiring an audit of the mortgage loans made by that subsidiary. OCC regulation, 12 C.F.R. § 7.4006, provides that state laws and regulations apply to national bank operating subsidiaries to the same extent as they apply to national banks.[10] The court found that OCC had authority under the National Bank Act to promulgate the regulation and that the regulation was a reasonable interpretation of legislation.

Preemption Standard

Although national banks are chartered by the federal government, much of their daily activity is determined by state law as with any other business operating in a state. National banks are federal instrumentalities, chartered to perform functions relating to, among other things, the national economy, the public debt, federal disbursements, and the payment system. Federalism involves balancing federal and state authority over such entities as national banks. The Supremacy Clause of the U.S. Constitution, Art. VI, cl. 2, declares that the Constitution and "the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." This means that Congress may override conflicting state laws by exercising any of its delegated powers. When Congress has preempted a state law, that law is unenforceable. Such was the ruling in *McCullough v. Maryland*, 17 U.S. (4 Wheat.) 316, 435 (1819), which declared a state law taxing notes issued by the First Bank of the United States to be void.

The starting point for preemption analysis is the language of the federal legislation. If Congress, under one of its delegated powers, has enacted a statute that includes an explicit statement that state law is preempted, the Supreme Court will generally give effect to that legislative intent. *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 605 (1991). Where there is no language of preemption, the Court is likely to find preemption when it identifies a direct conflict between the federal law and the state law or when it concludes that the federal government has so occupied the field as to preclude enforcement of state law with respect to the subject at hand. Generally, the federal courts have read Congressional grants of power to national banks as presumptively preemptive. In reaching such a conclusion about a federal statute granting national banks power to sell insurance from offices in towns with populations of not more than 5,000, the Supreme Court stated:

> In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress

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[9] 265 F. Supp. 2d 1162 (E.D. Cal. 2003).

[10] The court relied on various cases that treated operating subsidiary activities as equivalent to activities of the national bank: e.g., *Nationsbank of North Carolina. N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995); *Marquette National Bank of Minneapolis v. First Omaha Service Corporation*, 439 U.S. 299 (1978).

> 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.[11]

Under the *Barnett* standard, states may not enact laws that "forbid or impair significantly" or "prevent or significantly interfere with" a national bank's granted power. Earlier cases dealing with the same issue in various contexts adopted varying formulations of the test of whether or not there was preemption of a particular state law with respect to national banks.

Specifics of OCC's Preemption Regulations

Although the *Barnett* standard forms the basis of OCC's preemption analysis, the standard that OCC employs draws from other Supreme Court decisions to arrive at what may be a broader standard than formulated in *Barnett.* Under OCC's interpretation, where there is no federal statute delineating how state law is to be applied to national banks in a particular circumstance, state law would be applicable only if it is not "altering or conditioning a national bank's ability to exercise a power that Federal law grants to it." The OCC regulations cover real estate lending, deposit-taking, and other lending and specify that state laws that "obstruct, impair, or condition a national bank's ability to fully exercise" the power in question, are inapplicable, except "where made applicable by federal law."

> *Deposit taking.* Under 12 C.F.R. § 7.4007, national banks may exercise their deposit-taking powers without complying with state laws on: dormant accounts, checking accounts, disclosures, funds availability, savings account orders of withdrawal, state licensing or registration requirements, and special purpose savings services.
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> *Lending and Real Estate Lending and Appraisals.* Under 12 C.F.R. § 34.3, national banks may exercise their powers with respect to real estate lending and appraisals without complying with state laws on: credit enhancements, licensing, loan-to-value ratios, credit terms, aggregate amount of funds that may be loaned using real estate as security, escrow accounts, access to credit reports, disclosure and advertising, interest rates, due-on-sale clauses, and mortgage servicing or participation in mortgages. Under 12 C.F.R. § 7.4008, similar preemptions apply to other lending.
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> *State Laws Not Generally Preempted.* Throughout the regulations, OCC has identified some state laws that are presumed not to be preempted. Among them are state laws on: contracts, torts, criminal law, right to collect debts, acquisition and transfer of property, and zoning. To these may be added "any other law the effect of which OCC determines to be incidental to the exercise of national bank powers."
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> *Standard Under Which Any State Law May Be Preempted*. Under the regulations, OCC may issue preemption rulings or regulations upon finding that the "state laws ... obstruct, impair, or condition a national bank's ability to fully exercise its powers to conduct activities authorized under Federal law." 12 C.F.R. § 7(b). Under the regulations, it appears that if OCC determines that a state law in one of the categories that are presumed not to be preempted, such a law may be preempted if OCC finds the

[11] *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 33 (1996).

law to "affect the exercise of national bank powers," more than "incidentally." 12 C.F.R. § 7.4009(c)(2).

Anti-Predatory Lending Standard. Under the regulations, a national bank may not make a consumer loan based predominantly on the foreclosure or liquidation value of the borrower's collateral without regard to the borrower's ability to repay the loan according to its terms. There is also a statement that a national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act (FTC Act), 15 U.S.C. § 45(a)(1).[12]

Legislation

The House Financial Services Committee, in its "Views and Estimates of the Committee on Financial Services on Matters to Be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005," noted that the OCC rules reflect an expansion of authority "without congressional authorization, and without a corresponding increase in budget resources for the agency."[13]

On April 7, 2004, Senator Edwards introduced S.J.Res. 31 and S.J.Res. 32 to provide for congressional disapproval of the regulations, thereby overturning them, pursuant to the Congressional Review Act of 1996,[14] 5 U.S.C. §§ 808 et seq. Subsequently, Representative Guitierrez introduced two bills H.R. 4236 and H.R. 4237 to achieve the same objective. The 108th Congress did not act on these resolutions and bills.

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[12] 69 *Fed. Reg.* 1916 and 1917, 12 C.F.R. §§ 7.4008 (b) and (c) (non-real estate consumer loans) and 34.3 (b) and (c) (consumer loans secured by interest in real estate). OCC has used the FTC Act to take enforcement actions against certain national banks for abusive practices. See the OCC website, [http://www.occ.treas.gov/Consumer/Unfair.htm] (last visited, February 16, 2005). Others are summarized at 69 *Fed. Reg.* 1913. In one of the enforcement actions, *In the Matter of Clear Lake National Bank, San Antonio, Texas*, Enforcement Action 2003-135 (Nov. 7, 2003), a consent order required the bank to set aside $100,000 to reimburse approximately 30 consumers who had been subjected to abusive practices in connection with home equity loans. Available at the OCC website, [http://www.occ.treas.gov/FTP/EAs/ea2003-135.pdf] (last visited February 16, 2005).

[13] [http://financialservices.house.gov/media/pdf/FY2005%20Views_FINAL.pdf].

[14] See CRS Report RL31160, *Disapproval of Regulations by Congress: Procedures Under the Congressional Review Act*, by Richard S. Beth, and CRS Report RL30116, *Congressional Review of Agency Rulemaking: an Update and Assessment After Nullification of OSHA's Ergonomics Standard*, by Morton Rosenberg.