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OCC Moves to Implement Dodd-Frank Act Preemption Provisions

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The authors review the Dodd-Frank preemption provisions and new regulatory developments with respect to preemption.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended the National Bank Act ("NBA") to specifically address the preemption of state law. The Office of the Comptroller of the Currency ("OCC"), the regulator of national banks, recently issued two releases — a letter and a proposed regulation — regarding the implementation of the Dodd-Frank Act. These releases have provided important and long-awaited guidance into the OCC's interpretation of the Dodd-Frank Act preemption provisions and the continuing applicability of the preemption regulations adopted by the OCC in 2004 ("OCC Preemption Regulations").

As described more fully below, the OCC determined that the preemption standard the agency applied when issuing the OCC Preemption Regulations is consistent with the preemption standard under Section 1044 of the Dodd-Frank Act and thus the OCC Preemption Regulations are preserved under the Dodd-Frank Act. The OCC also indicated it will follow the new procedures for preemption determinations as adopted by the Dodd-Frank Act (*e.g.* case-by-case determinations supported by substantial evidence in the record)

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for specified preemption determinations after July 21, 2011.

These developments regarding the Dodd-Frank Act and the OCC Preemption Regulations are relevant to federal savings banks as well as national banks because the Dodd-Frank Act establishes the same general preemption framework for both types of institutions.

This article describes:

(1) the relevant preemption regulations from the OCC and the Office of Thrift Supervision ("OTS");

(2) the relevant preemption provisions from the Dodd-Frank Act;

(3) recent letters from members of Congress to the OCC on the preemption issues;

(4) the OCC's May 12, 2011 letter regarding preemption (the "OCC Preemption Letter"), and

(5) the OCC's proposed amendments to its preemption regulations, released on May 25, 2011 (the "OCC Proposed Regulations").

OCC AND OTS PREEMPTION REGULATIONS

In 2004, the OCC substantially revised its regulations regarding NBA preemption of state laws that purport to regulate national bank operations. After extensive examination of relevant judicial precedent on when state laws are preempted because they "conflict" with the NBA, the OCC concluded that the NBA preempts state laws that "obstruct, impair or condition" a national bank's ability to fully exercise it federally authorized powers.

The OCC Preemption Regulations identify several types of laws that the OCC determined do not apply to national banks under this general standard. For example, these regulations provide that state laws concerning licensing or registration, the terms of credit and disclosure requirements do not apply to loans made by national banks. On the other hand, the OCC Preemption Regulations provide that certain state laws that establish the general legal infrastructure that makes practicable the conduct of business (*e.g.* state laws regarding contracts, torts, and taxation) apply to national banks to the extent that the state laws only incidentally affect the bank's exercise of powers

granted by the NBA.

The types of laws that are preempted under the OCC Preemption Regulations are substantially similar to the types of laws that, under regulations adopted in 1996, the Office of Thrift Supervision ("OTS") concluded are preempted by the Home Owners Loan Act ("HOLA") for federal savings banks. However, the underlying basis of preemption under HOLA and the OTS regulations is that federal law "occupies the field" (*i.e.* "field preemption") rather than the general "conflicts" preemption underlying the OCC Preemption Regulations.

PREEMPTION PROVISIONS IN DODD-FRANK ACT

Section 1044 of the Dodd-Frank Act expressly limits the extent to which the NBA preempts "State consumer financial laws." That term is defined as laws that do not directly or indirectly discriminate against national banks, and that directly and specifically regulate the manner, content or terms and conditions of any financial transaction or related account with respect to a consumer.

Section 1044 provides that, subject to an exception for preemption related to interest rates, state consumer financial laws are preempted only if one of three preemption tests applies:

1. application of the law would have a discriminatory effect on national banks in comparison with the effect of the law on a bank chartered by that state;
2. in accordance with the legal standard for preemption in the U.S. Supreme Court decision in *Barnett Bank of Marion County v. Nelson*,[1] the state law prevents or significantly interferes with the exercise by the national bank of its powers (and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the OCC on a case-by-case basis in accordance with applicable law); or
3. the state law is preempted by a provision of federal law other than the NBA.

Section 1044 further provides that no regulation or order of the OCC prescribed under the subsection containing the *Barnett Bank* standard shall preempt a state consumer financial law unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with the legal standard of the decision of the U.S. Supreme Court in the *Barnett Bank* case.

The Dodd-Frank Act made two additional important preemption changes. First, the statute provides that state laws generally apply to federal savings banks to the same extent as they apply to national banks, and thus eliminated the "field preemption" previously enjoyed by federal savings banks. Second, the Dodd-Frank Act reverses provisions in the preemption regulations of both the OCC and the OTS that non-bank operating subsidiaries of national banks and federal savings banks enjoy the same preemption as the parent institution.

RECENT CONGRESSIONAL LETTERS TO OCC

In recent months, the OCC received two significant letters from members of Congress on the Dodd-Frank Act preemption provisions. First, in a letter to Acting Comptroller Walsh, dated March 8, 2011, Representative Barney Frank (D-MA) stated that Congress had grave concerns about the OCC Preemption Regulations and believed that the agency had included an overly broad interpretation of the preemption standard from the *Barnett Bank* case. He also indicated Congress expressly articulated the "prevents or significantly impairs" standard in the Dodd-Frank Act because it rejected the "obstruct, impair or condition" standard the OCC had included in the OCC Preemption Regulations, and concluded that "the OCC's preemption regulation no longer comports with federal law and therefore must be reversed or substantially overhauled." Representative Frank also indicated that the OCC Preemption Regulations did not meet the new requirement in the Dodd-Frank Act that any preemption determination be made on a "case-by-case" basis.

More recently, Senators Tom Carper (D-DE) and Mark Warner (D-VA) also sent a letter to Acting Comptroller Walsh, dated April 4, 2011, for the stated purpose of ensuring that the OCC's interpretation of the of Dodd-Frank Act preemption provision is consistent with the intent of the amend-

ment on the *Barnett Bank* standard that they authored and the full Senate adopted. The senators indicated their view that Section 1044 codified the preemption standard in the *Barnett Bank* case and that the reference to "prevent or significantly impair" was merely a shorthand reference to the traditional "conflict" preemption standard discussed in that decision. They also indicated that the requirement for the OCC to act on a case-by-case basis in making preemption determinations was not intended to apply retroactively to repeal the OCC Preemption Regulations.

OCC PREEMPTION LETTER

In the OCC Preemption Letter, addressed to Senator Carper, Acting Comptroller Walsh provided interpretations of Section 1044 and described the changes to the OCC Preemption Regulations that the OCC plans to propose.

To start, the OCC indicated that the conflict preemption standard under the *Barnett Bank* provision of Section 1044 is not limited to a state law that "prevents or significantly interferes with exercise by a national bank of its powers" (the phrase expressly included in the statutory language). Instead, the OCC interprets Section 1044 as requiring consideration of the whole conflict preemption analysis in the *Barnett Bank* decision.

The OCC also indicated that its effort to distill the preemption principles from the *Barnett Bank* case (and the cases cited in *Barnett Bank*) into an abbreviated regulatory preemption standard (*i.e.* the "obstruct, impair or condition" standard) may have caused uncertainty. As a result, the letter provides that the OCC plans to propose to remove the "obstruct, impair or condition" formulation from its preemption regulations. However, the agency concluded that the OCC Preemption Regulations are preserved under the Dodd-Frank Act standard because they are consistent with the preemption principles in the *Barnett Bank* case.

The OCC Preemption Letter further provides that the OCC will follow the new procedures and consultations with respect to preemption determinations going forward, after July 21, 2011. The OCC indicated that these procedures include the requirement for the OCC to make determinations under the *Barnett Bank* standard on a case-by case basis, to consult with the

Consumer Financial Protection Bureau on certain preemption determinations, and to have substantial evidence on the record to support a preemption order or regulation under the *Barnett Bank* standard.

The OCC indicated that it also plans to propose rescission of its regulations on application of state laws to national bank operating subsidiaries. Further, because of the changes to the preemption standards under the HOLA, the OCC Preemption Letter states that the OCC plans to propose amendments to its regulations to make clear that federal savings banks and their subsidiaries are subject to the same preemption standards as apply to national banks and their subsidiaries, respectively. Finally, the OCC stated that it planned to propose changes to its visitorial powers regulation, to reflect the codification of the Supreme Court's decision in *Cuomo v. Clearing House Ass'n, L.L.C.*,[2] in Section 1047 of the Dodd-Frank Act.

The OCC Preemption Letter has drawn some support, but also criticism from advocates of greater state authority to regulate national banks. Notably, Prof. Arthur Wilmarth, at the George Washington University Law School, has argued that the OCC's interpretation is at odds with the statute.

OCC PREEMPTION REGULATIONS

Shortly after releasing the OCC Preemption Letter, the OCC released a formal proposal to amend its Preemption Regulations.[3] The Proposed Regulations generally seek to implement the positions set forth in the Preemption Letter. In that regard, the OCC Proposed Regulations would amend the substantive preemption rules, at 12 C.F.R. §§ 7.4007 (deposit taking), 7.4008 (lending) and 34.4 (real estate lending), by:

- Removing the general standard that "state laws that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized" powers are preempted, concluding that removal of this language was appropriate to eliminate any ambiguity that *Barnett Bank*'s conflict preemption standard is the governing standard for national bank preemption; and
- Revising the "catch-all" language for other state laws that are generally applicable to national banks to refer to laws "that the OCC determines

to be applicable to national banks in accordance with" the *Barnett Bank* standard. The OCC's new language refers directly to *Barnett Bank*, but does not include the "prevents or significantly interferes" language found in the Dodd-Frank amendment.

As contemplated by the OCC Preemption Letter, however, the OCC would generally retain its preemption regulations. Although recognizing that a "case-by-case" determination on preemption is required after July 21, 2011, the OCC concludes that the process applies only prospectively, and does not invalidate the existing regulations. The OCC is proposing to delete 12 C.F.R. § 7.4009, which addresses preemption of state law in the context of national bank "operations."

In the OCC Proposed Regulations, the OCC notes that the preemption changes under the Dodd-Frank Act are applicable only to the category of "state consumer financial laws," defined as laws that do not directly or indirectly discriminate against national banks, and that directly and specifically regulate the manner, content or terms and conditions of any financial transaction or related account with respect to a consumer. However, the proposed amendments to the regulations do not elaborate on the distinction between that category and other state laws.

The OCC Proposed Regulations would modify the OCC's visitorial powers regulation, at 12 C.F.R. § 7.4000, by adding new language to conform to the Supreme Court's 2009 decision in *Cuomo*, and by adding a new "exclusion" expressly referencing *Cuomo* and permitting state attorneys general to bring actions in court to enforce a non-preempted law against a national bank. In addition, the OCC Proposed Regulations would delete existing 12 C.F.R. § 7.4006, which addressed operating subsidiaries, in order to implement the Dodd-Frank Act amendments that eliminate federal preemption for operating subsidiaries. A conforming amendment would be made to 12 C.F.R. § 5.34, which relates to the organization of operating subsidiaries.

For federal savings banks, the OCC Proposed Regulations would add new provisions to address preemption, at 12 C.F.R. §§ 7.4010 and 34.6. Those sections would specifically reference the relevant provisions of the Dodd-Frank Act, and provide that "state laws apply to Federal savings associations and their subsidiaries to the same extent and in the same manner

that those laws apply to national banks and their subsidiaries." The existing OTS regulations would be repealed.

NOTES

[1] 517 U.S. 25 (1996).
[2] 129 S. Ct. 2710 (2009).
[3] 76 Fed. Reg. 30557 (May 25, 2011).