

# Preemption Developments Impacting Interstate Lending by Federally Regulated Financial Institutions

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## I. Introduction

The federal banking agencies continued to work overtime in 2003 and early 2004 issuing preemption-related determinations, letters and rules. The Office of the Comptroller of the Currency (OCC) began 2003 with the proposed amendments to its visitorial powers regulation and later in the year issued a more detailed proposed preemption rule. In early 2004 the OCC issued both rules in final

form with few changes, despite strong opposition from certain groups. Over this same period the Office of Thrift Supervision (OTS) found all state predatory lending law provisions that it examined to be preempted. In addition, the courts have continued to address federal preemption with sometimes conflicting results. This article provides a summary of the regulatory issuances and court decisions regarding preemption issued during late 2002, 2003, and the first part of 2004, and discusses how they impact interstate lending by federally-regulated financial institutions.

## II. OCC Issues Final Rules on National Bank Preemption and Visitorial Powers

### A. Introduction

On January 7, 2004, the OCC issued two long awaited rules. The first clarifies issues related to the OCC's exclusive visitorial powers over national banks, while the second clarifies what types of state laws apply to national banks.<sup>1</sup> The rules took effect February 12, 2004.

### B. Preemption Rule

The preemption rule specifies the types of state laws that do not apply to national banks' lending and deposit activities and the types of state laws that generally do apply to national banks. The lists of types of state laws that are not preempted in the final rule are substantively the same as in the proposed rule.

1. 69 Fed. Reg. 1895 (visitorial powers); 69 Fed. Reg. 1904 (preemption) (Jan. 13, 2004).

In the list of laws not preempted, the reference to “debt collection laws” in the proposed rule was revised in the final rule to refer to state laws concerning national banks’ “rights to collect debts.”

The final rule states that except where made applicable by federal law, state laws that “obstruct, impair or condition” a national bank’s exercise of its lending, deposit-taking, or other federal powers do not apply to national banks. In its comments, the OCC stated that the final rule does not entail any new powers for national banks or any expansion of national banks’ existing powers. The OCC stated that the preemption standards in the final rule are consistent with the standards articulated by the United States Supreme Court.<sup>2</sup>

The OCC final rule contains new provisions prohibiting the making of any type of consumer loan based predominantly on the bank’s possible realization of the foreclosure value of the borrower’s collateral without regard to the borrower’s ability to repay the loan. The final rule also adds a new provision that explicitly prohibits a national bank from engaging in practices that are unfair or deceptive under the Federal Trade Commission Act.<sup>3</sup>

The OCC stated that, based on existing regulations, the final rule applies to operating subsidiaries. In a chart comparing the scope of national bank, thrift, and credit union preemption, the OCC indicated that its rule has substantially the same scope as the OTS rule for thrifts.<sup>4</sup>

### C. Visitorial Powers Rule

The OCC visitorial powers rule is substantively the same as the proposed rule, with a few modifications. The final rule clarifies the scope of the OCC’s exclusive visitorial authority over national banks with regard to activities authorized under federal law. The rule also clarifies the limited exception to the OCC’s ex-

clusive visitorial power as vested in the courts of justice. In its comments, the OCC stated that the final rule is consistent with federal law and the dual banking system.

### III. National Bank Operating Subsidiaries Preemption

#### A. California Decisions on State Auditing Authority

In the *Boutris* cases the United States District Court for the Eastern District of California ruled in favor of Wells Fargo Bank, N.A. and Wells Fargo Home Mortgage, Inc. (a wholly-owned operating subsidiary of Wells Fargo, N.A., a national bank) and National City Bank of Indiana and National City Mortgage Co. (a wholly-owned operating subsidiary of National City Bank of Indiana, a national bank) in determining that the Commissioner of the California Department of Corporations (Commissioner) does not have authority to audit national bank operating subsidiaries.<sup>5</sup> Both bank operating subsidiaries had obtained California Residential Mortgage Lender licenses. The Commissioner sought to audit the residential mortgage lending activities of the bank operating subsidiaries, including compliance with the California per diem statute.

The banks and their operating subsidiaries argued that the National Bank Act (NBA)<sup>6</sup> grants the OCC exclusive authority to exercise visitorial powers over national banks and their operating subsidiaries, and that the state Commissioner had no authority to examine or regulate them. They also argued that under the NBA the operating subsidiaries are not required to hold a license under California law to engage in mortgage lending in California. The OCC filed an amicus brief supporting the plaintiffs’ position.

The *Boutris* court gave deference to the OCC’s construction of the NBA, including statements in the OCC’s amicus brief. The court held that the Commissioner had no visitorial powers over the bank operating subsidiaries and that the California license did not affect the right of the operating subsidiaries to conduct federally-permissible banking activities. The court also held that the California law prohibiting the charging of interest on mortgage loans for a period in excess of one day prior to recording (the per diem statute) was preempted by section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980.<sup>7</sup> The court found that the state law restricted the time period in which interest can be collected and thus “expressly limits the rate or amount of interest...which may be charged....”

#### B. OCC Interpretative Letter

The OCC in an interpretive letter stated that national bank operating subsidiaries may impose and export interest charges under the same terms and conditions applicable to the parent national bank.<sup>8</sup> This conclusion was based on the applicability of 12 U.S.C. section 85 of the NBA to the operating subsidiaries of national banks pursuant to OCC regulations in 12 C.F.R. sections 5.34 and 7.4006.

The OCC held that a wholly-owned operating subsidiary of a national bank, with both the bank and the subsidiary headquartered in Michigan, may rely on the NBA<sup>9</sup> and export Michigan’s interest rate for real estate-secured loans made by the subsidiary to residents of states other than Michigan or secured by real estate located in states other than Michigan.<sup>10</sup> Based on relevant OCC regulations regarding operating subsidiaries and the

2. 69 Fed. Reg. 1904, 1910.

3. 15 U.S.C. § 45(a)(1) (often called “Section 5”).

4. Available at [www.occ.treas.gov/2004-3fcomparisonchart.pdf](http://www.occ.treas.gov/2004-3fcomparisonchart.pdf).

5. *National City Bank of Indiana v. Boutris*, No. CIV 503655 GEB JFM, 2003 WL 21536818 (E.D. Cal. July 2, 2003); *Wells Fargo Bank N.A. v. Boutris*, 252 F.Supp 2d. 1065 (E.D. Cal. 2003).

6. 12 U.S.C. §§ 21 *et seq.*

7. 12 U.S.C. § 1735f-7a.

8. OCC Letter No. 968 from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel (Feb. 12, 2003).

9. 12 U.S.C. § 85.

10. OCC Letter from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel (Dec. 16, 2002).

exportation authority of a national bank, and citing *Marquette National Bank of Minneapolis v. First Omaha Service Corp.*<sup>11</sup> for the proposition that a national bank is located in the state in which the bank's main office is located, the OCC concluded that, as a national bank operating subsidiary, the subsidiary can export Michigan interest rates under the same terms and conditions applicable to the bank.

#### IV. Federal Savings Bank Preemption

##### A. California Consumer Credit Reporting Decision

A California Court of Appeals found that triable issues of material fact existed with regard to a consumer's state law claim against World Savings and Loan Association, a federal savings bank, under the California Consumer Credit Reporting Agencies Act.<sup>12</sup> The *Hussey-Head* court rejected the bank's argument that even if triable issues of material fact existed, the state law restrictions on providing information to credit reporting agencies were preempted by 12 C.F.R. section 560.2. The California law in question prohibits the furnishing of information on a specific transaction or experience to any consumer credit reporting agency if the person knows or should know the information is incomplete or inaccurate.<sup>13</sup> The statute also contains a disclosure requirement.

The applicable OTS regulation provides that the OTS occupies the entire field of lending regulations for federal savings banks. Section 560.2(b) lists examples of preempted state laws, including laws purporting to impose requirements regarding "access to and use of credit reports," "disclosure and advertising," and "processing, origination,

servicing, sale of, or participation in, mortgages."<sup>14</sup> Despite the specific references in OTS section 560.2(b) to state laws like the California law at issue, the *Hussey-Head* court held that the California law is not preempted by section 560.2 because the California law is not a lending regulation and the bank voluntarily reports credit information to credit reporting agencies.

The *Hussey-Head* court also found that the law does not govern how the bank runs its lending program. Rather, the court found that the law attempts to insure that information reported voluntarily is reported in a fair and accurate manner. The court held that as the state law restriction does not come into play until after a loan is made and does not affect the manner in which the lender services or maintains the loan, it is not inconsistent with federal law. The court also noted that the statute does not on its face purport to regulate federal savings banks and is not specifically directed toward them. The court concluded that any effect the state law has on the bank was "incidental" rather than material and was the result of the bank's voluntary action to report information to credit reporting agencies.

##### B. Ohio Mortgage Release Decision

The Ohio Supreme Court held that an Ohio law requiring that within ninety days from the date of the satisfaction of a residential mortgage loan the mortgagee must record the satisfaction was not preempted by 12 C.F.R. section 560.2.<sup>15</sup> The *Pinchot* court concluded that a satisfaction recording requirement does not fall within the list of preempted state laws in OTS section 560.2(b).<sup>16</sup> In response to the lender's arguments, the court found that such a law does not impose requirements on the "origination" or "servicing" of mortgages.

Additionally, the *Pinchot* court held that the Ohio law did not affect the lending operations of a federal savings bank, as it regulates the period after the loan is satisfied. The court concluded that the state law was not preempted. Although an analysis under section 560.2(c) was not required given the above holdings, the *Pinchot* court stated that the state law was a real property statute intended to promote efficiency and certainty in clearing and transferring title to property and had only an incidental effect on the federal savings bank's lending practices. Although a state regulator could not enforce the state law against a federal savings bank, the court found no authority forbidding a private individual from enforcing a state law that permitted a private action.

##### C. Payoff Fees in California

The California Court of Appeals held that federal law preempted a California statute limiting payoff statement fees as applied to a federal savings association.<sup>17</sup> Class action plaintiffs challenged the practice of a federal savings and loan association of charging a fee for the transmission of a payoff statement in excess of the amount permitted under California Civil Code section 2943. The plaintiffs alleged that charging the fee in violation of the California statute was an unfair, deceptive and unlawful business practice in violation of California's Unfair Competition Act. The defendant sought summary judgment on the basis of federal preemption.

The *Lopez* court stated that the OTS was authorized by Congress to promulgate 12 C.F.R. section 560.2 and that federal regulations have no less preemptive effect than federal statutes. The court found that section 560.2 preempts all state laws purporting to regulate any aspect of the lending operations of a federally-chartered savings association, whether or not the OTS has adopted a rule or

11. 439 U.S. 299 (1978).

12. *Hussey-Head v. World Savings and Loan Ass'n*, 4 Cal. Rptr. 3d 171 (Cal. Ct. App. 2003).

13. Cal. Civ. Code § 1785.25(a).

14. 12 CFR § 560.2 (b)(8),(9),(10).

15. *Pinchot v. Charter One Bank, FSB*, 99 Ohio St. 3d 390 (2003).

16. 12 CFR § 560.2(b).

17. *Lopez v. World Sav. and Loan Ass'n*, 105 Cal. App. 4th 729 (2003).

regulation governing the precise subject of the state provision. Thus, the court found that OTS section 560.2 broadly preempts state law restrictions on loan servicing fees, including the payoff statement fees specifically dealt with in the California statute. As the California statute limiting payoff statement fees was preempted, the court held that any claim under the Unfair Competition Act based on a violation of the California statute was also preempted.

**D. Forced-Placed Insurance**

A California Court of Appeals held that borrowers' actions against a federal savings bank to recover under a state unfair competition statute for charges related to forced-placed insurance were not preempted.<sup>18</sup> The *Gibson* court found that the plaintiffs' claims were predicated on the duties of a contracting party to comply with its contractual obligations and to act reasonably to mitigate damages in the event of a breach by the other party, the duty not to misrepresent material facts, and the duty to refrain from unfair or deceptive business practices.

The contract entitled the defendant to advance a sum necessary to protect its loan security. When the plaintiffs failed to maintain the required insurance on the security, the defendant purchased replacement insurance policies that were much more expensive than the plaintiffs' policies. The *Gibson* court held that the plaintiffs' claims were not based on laws of the type listed in OTS section 560.2 or on laws that affect lending businesses. Rather, the court found that the borrowers' claims involved state laws of general application that affect lending only incidentally. Therefore, the court concluded that the borrower's claims were not preempted by OTS regulations.

**V. National Bank Usury Preemption**

**A. U.S. Supreme Court Usury Decision**

The Supreme Court of the United States held that the NBA provides the exclusive cause of action for usury claims against national banks.<sup>19</sup> The Court reversed a decision of the U.S. Court of Appeals for the Eleventh Circuit that found no clear congressional intent to permit removal under 12 U.S.C. sections 85 and 86 of the NBA, and that sections 85 and 86 do not completely preempt state usury claims.<sup>20</sup> The Eleventh Circuit responded by issuing an opinion affirming the district court decision and remanding the case to the district court for further proceedings consistent with the Supreme Court's decision.<sup>21</sup>

**B. OCC Advisory Letter on Enforcement Authority**

The OCC issued an Advisory Letter describing the general principles that apply when determining if a state law applies to a national bank, and if the OCC has the exclusive enforcement authority in regard to national banks.<sup>22</sup> The Advisory Letter provides that Congress vested in the OCC broad authority to regulate the conduct of national banks, except where the authority to issue such regulations has been "expressly and exclusively" given to another federal regulatory agency. The Advisory Letter recognizes that state law could be applicable to national banks in limited circumstances, when it does not conflict or interfere with the national bank's exercise of its powers. The Advisory Letter quotes language from *Bank of America*

*v. City and County of San Francisco*<sup>23</sup> noting that, for instance, the federal courts recognize that the states retain some power to regulate national banks in areas such as "contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law."<sup>24</sup> The quote would indicate that the OCC believes that state laws governing the areas referenced by the Ninth Circuit in the quoted language would apply to national banks if the state law does not conflict or interfere with the national bank's exercise of its power.

In the Advisory Letter the OCC advises national banks to consult with the OCC regarding the application and enforcement of state law in a particular instance, due to the often complex nature of such determinations. The Advisory Letter also states that it is the OCC that has the authority to enforce applicable state laws as to national banks and that state officials should contact the OCC if state officials have information or concerns regarding a national bank's potential violation of state or federal law.

**VI. National Bank Non-Interest Fee Preemption**

**A. Kentucky Decision on Non-Interest Fees**

The United States District Court for the Western District of Kentucky found complete preemption lacking with regard to non-interest fees charged by a national bank.<sup>25</sup> The *Hancock* case involved a challenge to the bank's practice of charging a \$15 fax fee for faxing loan payoff statements. Unlike the interest fees authorized under section 85, which the United States Supreme Court found in *Anderson* to completely preempt state law usury claims (see discussion *supra* at Part V.A.), non-interest fees are permitted based on 12 U.S.C. section 24 (Seventh). The *Hancock* court found

18. *Gibson v. World Savings and Loan Ass'n*, 103 Cal. App. 4th 1291 (Cal. App. 4 Dist. 2002).

19. *Beneficial Nat'l Bank v. Anderson*, 123 S. Ct. 2058 (2003).

20. *Anderson v. H&R Block*, 287 F.3d 1038 (11th Cir. 2002).

21. *Anderson v. H&R Block*, 344 F.3d 1131 (11th Cir. 2003).

22. OCC Letter FL 2002-9 from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel (Nov. 25, 2002).

23. 309 F.3d 551 (9th Cir. 2002).

24. *Id.*, at 559, citing *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).

25. *Hancock v. Bank of Am.*, 272 F.Supp. 2d 608 (W.D. Ky. 2003).

section 24 (Seventh) to be a broad enabling provision and not a provision that eliminates a state law case of action. Thus, the court found that removal of the suit challenging a \$15 fax fee was improper.

#### B. Fifth Circuit Decision on Check-Cashing Fees

The Fifth Circuit U.S. Court of Appeals held that national banks are authorized by federal regulation<sup>26</sup> to charge non-account holding payees a check-cashing fee.<sup>27</sup> The case involved a Texas "Par Value" statute that prohibits banks from charging a fee to non-account holding payees who present a check to the payor bank (the bank that holds the account that the check is drawn against). Wells Fargo Bank of Texas, a national bank, sought a permanent injunction and declaration that the Texas Par Value statute was null and void based on federal preemption, relying on 12 C.F.R. section 7.4002(a).

The court found that the OCC was operating within its power in promulgating section 7.4002. Section 7.4002 provides that national banks may charge "customers" non-interest charges and fees for authorized services. The OCC interprets "customers" to include any person who presents a check for payment.<sup>28</sup> Although the court acknowledged that such an interpretation of customer is not the only reasonable interpretation, the court concluded that the OCC's interpretation that customer includes payees who present a check to a drawee bank for payment due is controlling. The court held that because the Texas Par Value statute prohibits the exercise of a power that federal law expressly grants to national banks, the Par Value statute is in irreconcilable conflict with the federal

regulatory scheme and it is preempted by operation of the Supremacy Clause of the U.S. Constitution.

#### VII. State Debt Collection Act Not Preempted

The National Credit Union Administration (NCUA) issued an opinion letter stating that federal law does not preempt the Texas Debt Collection Act and thus a federal credit union must comply with that law to the extent that it has members who are Texas residents.<sup>29</sup> The letter explains that the NCUA's lending regulation specifies that it is not the intent of the NCUA to preempt state laws affecting aspects of credit transactions that are primarily governed by federal laws other than the Federal Credit Union Act, including state laws concerning debt collection practices.<sup>30</sup>

The NCUA letter refers to the Fair Debt Collection Practices Act (FDCPA), which anticipates that states may also regulate this area.<sup>31</sup> The FDCPA provides that state efforts to regulate debt collection practices will not be considered inconsistent, for preemption purposes, if the differences in the state law provide relatively greater protection to the consumer. The NCUA concluded that the Texas Debt Collection Act meets this standard. Finally, the NCUA letter states that any state official asserting a claim against a federal credit union involving the Texas law or any other applicable state law relating to lending activities would need to refer the matter to the appropriate NCUA regional office, based on the NCUA's exclusive examination and enforcement jurisdiction. The Texas law has since been amended and the special disclosure requirement no longer applies to a creditor acting on its own behalf in collecting an overdue debt.

#### VIII. Predatory Lending Laws Preempted

##### A. OTS Letter *Re* New Mexico Law

The OTS issued a preemption letter finding that federal law preempts the provisions of the New Mexico Home Loan Protection Act and precludes those provisions from applying to federal savings banks and their operating subsidiaries.<sup>32</sup> The OTS previously addressed similar provisions of the Georgia, New Jersey, and New York predatory lending laws. The OTS letter on New Mexico states that, for the reasons addressed in prior letters, New Mexico provisions purporting to regulate the terms of credit, loan-related fees, disclosures, mortgage processing, origination, refinancing and servicing, and disbursements are preempted from applying to federal savings banks.

For the same reasons, the OTS stated that the New Mexico Act's compliance scheme could not be applied to a federal savings bank in a manner that would compel compliance with the preempted provisions. The OTS stated that the provisions preempted from applying to federal savings banks in this manner include those: (1) using state foreclosure law as a tool to compel compliance; (2) allowing borrowers to bring civil actions for violations and to assert claims, defenses, counterclaims and actions against creditors or subsequent holders or assignees including in foreclosures actions; (3) deeming violations to be unfair or deceptive trade practices; and (4) providing for administrative enforcement by the Financial Institutions Division of the New Mexico Department of Regulation and Licensing.

26. 12 CFR § 7.4002(a)

27. *Wells Fargo Bank of Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003).

28. *Cf.* the meaning of "customer" as defined in the Uniform Commercial Code at § 4-104(a)(5) (2003 uniform text), or in the Gramm-Leach-Bliley Act implementing regulations at 16 CFR § 313.3(h).

29. NCUA Letter from Sheila A. Albin, Associate General Counsel (Nov. 26, 2003).

30. 12 CFR § 701.21(b)(3).

31. 12 U.S.C. § 1692n.

32. OTS Letter P-2003-6 from Carolyn Buck, Chief Counsel (Sept. 2, 2003).

