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Regulatory: Federal Bank Preemption

Congress codifies, overturns Supreme Court decisions.

By Martin Bishop
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This column is the third in a series of articles on the coming of the Consumer Financial Protection Bureau and the direction it is likely to take in the regulation of consumer financial products and services.

After the creation of the Consumer Financial Protection Bureau, one of the most talked about changes in Title X of the Dodd-Frank Act is the codification of certain preemption concepts as they are applied to national banks. To properly understand them requires a brief history lesson.

The United Stated developed a dual banking system. Under what is now the National Bank Act, there is a federal system based on national bank charters, and a state system, based on state charters. Under the National Bank Act (and subject to other laws), a national bank association has the power to do what it needs to do to carry on its banking business.

In 1994, during an era marked by national bank expansion across state lines, Congress clearly set forth its intent to create a zone of freedom from state regulations when it adopted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal"). Riegle-Neal set a new preemption standard for national banks in America by providing that national banks were subject to state consumer laws as if they were branches of a state bank except when federal law preempted the application of a state law to a national bank or if the Office of the Comptroller of Currency ("OCC") determined that a state law discriminated against national banks. Courts later began holding that Riegle-Neal gave the OCC the authority to enforce state consumer laws even if they were not preempted. Reigle-Neal is historically significant because it opened the door to the possibility of many different state laws applying to national banks.

Against the backdrop of interstate expansion, in 1996, the United States Supreme Court issued a seminal decision in *Barnett Bank of Marion County, N.A. v. Nelson*. The facts of *Barnett Bank* are straightforward. At the time, a Florida law proscribed Florida licensed insurance agents from engaging in certain insurance agency activities where the agent was associated with, among other things, any bank other than one which was not a subsidiary or affiliate of a bank holding company, and was located in a city with a population of less than 5000 people. Barnett Bank, a national bank affiliated with a holding company, bought a Florida licensed insurance agency and, as the National Bank Act permitted, intended to sell insurance through one of its branches in a town with a population under 5,000 people. Florida's Insurance Commissioner ordered Barnett to stop selling the insurance at the branch because it was prohibited under the state statute. Barnett subsequently filed suit, arguing that the National Bank Act preempted Florida's statute.

The United States Supreme Court sided with Barnett Bank, holding that "Congress would not want States to forbid, or impair significantly, the exercise of power that Congress explicitly granted." The Court went on to say that States could regulate national banks when "doing so does not prevent or significantly interfere with the national bank's exercise of its powers;" so called "conflict preemption." In the wake of the Barnett Bank decision, lower courts routinely found state statutes preempted.

In 2004, the OCC issued its preemption rule, which appeared to expand the holding of *Barnett Bank* and declared that a national bank's ability to exercise its incidental powers – including activities such as lending and deposit taking – preempted all state laws that "obstruct, impair or condition" the business of banking. Many viewed this OCC regulation as a statement of "field preemption," and courts gave the rule a lot of deference.

In the 2007 *Watters v. Wachovia* decision, the United States Supreme Court chimed in again on the preemption issue, holding that subsidiaries of national banks were entitled to the same preemption standards as their parent national bank to the extent the subsidiary was exercising a banking power. Two years later, the Court spoke up again about preemption in *Cuomo v. Clearing House Association*. *Cuomo* is important because (a) the Court held that federal banking laws do not preempt state attorneys general from suing national banks for violations of state fair lending and consumer laws, and (2) it was the Court's last word on banking preemption before Title X and Dodd-Frank.

Title X changes a lot about preemption; perhaps most importantly is the codification of the preemption standard. Specifically, Section 1044 of Title X provides that preemption of state consumer financial laws is permitted only if: (1) the application of a state consumer financial law would have a discriminatory effect on national banks; (2) the state law is preempted under the *Barnett Bank* standard; or (3) the state law is preempted by another provision of federal law other than the Dodd-Frank Act. Where a state consumer financial law has substantially similar terms as any law the OCC preempts, Title X requires the OCC to consult with the Bureau before making a decision to preempt the state law. In addition, Title X provides that national bank operating subsidiaries must comply with state law, overturning the *Watters* decision, and allows state attorneys general to enforce non-preempted state laws against national banks, codifying *Cuomo*.

On May 12, 2011, the OCC sent a letter to certain members of Congress outlining the OCC's views of its preemption powers in light of the new preemption provisions of Title X. The detailed letter basically sets forth the OCC's view that, while Title X requires certain changes (including those noted above), its 2004 preemption rule – which state regulators argue goes beyond the "significant interference" standard of *Barnett* and its progeny – will govern preemption decisions going forward. Thus, a battlefield was laid for state regulators and the OCC to scuffle over the scope of preemption under Title X.

In coming installments, we'll turn our attention to enforcement and some of the least discussed, yet potentially most important, provisions in Title X: the bureau's power to regulate unfair, deceptive, or abusive acts or practices.

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