



# Wall Street Reform and Consumer Protection Act

*Summary for Attorneys General*

*Prepared by the Presidential Initiative Working Group  
November 2010*



# *Introduction*

In July of 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Act”) was signed into law by President Barack Obama.<sup>1</sup> At more than 2,000 pages, the law makes broad changes to the financial system in the United States. An important part of the legislation is the creation of a new regulatory agency, the Consumer Financial Protection Bureau, which will oversee financial products introduced into the marketplace. The law also addresses derivatives regulation, the failure of non-depository institutions, proprietary trading, rating agencies and mortgage origination standards.

As the chief law enforcement officers of the States, Attorneys General have long played a critical role in protecting consumers from financial harm. From stopping scammers to backing prohibitions on predatory lending, Attorneys General are active and effective in addressing consumers’ complaints and advocating for change. The Act preserves that role and expands the tools available to Attorneys General by authorizing them to enforce certain provisions of the law and related regulations.

As this year’s President of the National Association of Attorneys General, North Carolina Attorney General Roy Cooper has focused his Presidential Initiative, titled “America’s Financial Recovery: Protecting Consumers While We Rebuild,” on ensuring that consumers have a level, fair, and transparent financial playing field. One of his goals is to establish a meaningful, cooperative partnership between the Attorneys General and the new Bureau. A multistate working group will develop principles and protocol around areas of common interest between the Bureau, State AGs, and in some cases, interested industry. The areas of common interest already identified: (1) data sharing, (2) enforcement coordination, and (3) preemption of state law.

This document summarizes relevant provisions of the law related to the creation of the Bureau and highlights some sections of importance to the Attorneys General in crafting a partnership with this new Federal agency.

## **CONSUMER FINANCIAL PROTECTION BUREAU**

### **Overview**

The creation of the Bureau as the new regulator overseeing the financial products or services in the consumer marketplace is the centerpiece of the legislation. By statute, the Bureau has five functions:

1. To ensure that consumers have timely and understandable information to make responsible decisions about financial transactions;
2. To ensure that consumers are protected from unfair, deceptive, or abusive acts or practices and discrimination;
3. To identify and update any outdated, burdensome consumer financial protection regulations;
4. To ensure consistency in the enforcement of consumer financial law without regard to status of the financial institution offering the product or service; and
5. Promoting a transparent and efficient consumer financial marketplace.

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<sup>1</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) [hereinafter referred to as “Dodd-Frank Act”]

## Structure

The Bureau is an autonomous executive agency housed within the Federal Reserve System but not subject to its authority. The Director is nominated by the President and confirmed by the Senate for a 5-year term. The statute forbids congressional appropriations oversight of the Bureau's budget or interference from the Board of Governors of the Federal Reserve System. The Director is given sole discretion over creation of the Bureau's budget, subject to an overall cap. That cap is fixed at 10% of the Federal Reserve System's 2009 operating budget for the first year, rising to 12% of that value over time (with the 2009 operating budget baseline being increased by average federal and state payroll cost increases each year). In dollar amounts, that puts the Bureau's budget at about \$408 million for the first year and \$490 million (in 2009 dollars) for future years.

The Bureau's initial workforce will be drawn from a number of positions currently scattered across other agencies (the Federal Reserve, Federal Trade Commission, Federal Deposit Insurance Commission, Housing and Urban Development, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, etc). The statute defines an 18-month transitional period, by the end of which these workers will be brought inside the Bureau.

The Act requires certain offices to be established within the Bureau. Those offices are organized around the following issues or populations: research; community affairs; consumer complaints; fair lending and equal opportunity;<sup>2</sup> financial literacy;<sup>3</sup> service members;<sup>4</sup> and senior citizens.<sup>5</sup>

## Covered Entities

With a few exceptions, any entity that provides financial products or services for the personal, family, or household use of consumers is a "covered person" and will be subject to the Bureau's jurisdiction.<sup>6</sup> Among other activities, this includes brokering, offering, and servicing loans; taking deposits and transmitting or exchanging funds; check cashing services; debt collection; and certain kinds of individual financial advising including credit or debt counseling.

A number of entities are specifically exempt from rulemaking jurisdiction by the Bureau.<sup>7</sup> However, this exemption generally only extends to the entity if it is not offering consumer financial products or services; to the extent it is offering consumer financial products or services, the entity may come under the Bureau's rulemaking authority. Exempted entities include:

- Motor vehicle dealers, unless the dealer offers credit to consumers to purchase or lease a vehicle and the dealer or an affiliate keeps the loan. The dealer may also be subject to Bureau rulemaking if it offers credit for a product unrelated to the purchase, lease, or repair of a vehicle.

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<sup>2</sup> *Id.* § 1013 (c). This Office will oversee enforcement and oversight of Federal fair lending laws.

<sup>3</sup> *Id.* § 1013 (d). This Office will responsible for "developing and implementing initiatives intended to education and empower consumers to make better financial decisions."

<sup>4</sup> *Id.* § 1013 (e). This office will be responsible for developing programs to increase the financial literacy of service members and their families, as well as to monitor complaints made by service members.

<sup>5</sup> *Id.* § 1013 (g). This office will be responsible for initiatives to increase the financial literacy of Americans over the age of 62.

<sup>6</sup> *Id.* § 1002 (6).

<sup>7</sup> *Id.* § 1029.

- Merchants and sellers of non-financial goods or services, if the accounts are kept in-house and the credit does not significantly exceed the market value of the goods or services sold. These entities will be subject to the Bureau's rulemaking if the amount of credit extended is significantly higher than the market cost of the product or service, or in the case where the accounts are assigned or sold just prior to delinquency or default.<sup>8</sup>
- Real estate brokers
- Manufactured and modular home retailers, to the extent a retailer is not involved in the financing of the home.
- Accountants and tax preparers
- Attorneys, however attorneys engaged in for-profit debt settlement, debt collection, or foreclosure prevention activities are subject to the Bureau's rulemaking authority but not enforcement or supervision authority. Supervision and enforcement is left to the FTC and/or appropriate state authorities.
- Activities related to charitable contributions
- Employee benefit and compensation plans
- Persons regulated by other agencies, including a state securities commission, state insurance regulator, the Securities and Exchange Commission, and Commodities and Futures Trading Commission, and the Farm Credit Administration.

In addition, the Act allows the Bureau to categorically exempt any entity by rule "as the Bureau determines necessary or appropriate in order to carry out the purposes and objectives of the title."<sup>9</sup> Importantly, with respect to merchants, retailers, and sellers of non-financial goods, to the extent that an entity is excluded from enforcement of consumer financial protection law or rules by the Bureau, the entity is similarly exempt from enforcement of the same law or rules by State Attorneys General.<sup>10</sup>

## Rulemaking

An important part of the Bureau's authority will be in writing rules to prevent bad products and practices from entering the market in the first place. To promote efficiency and consistency, the Act consolidates the authority to promulgate regulations pursuant to a number of existing consumer protection statutes and transfers that authority to the Bureau.<sup>11</sup> The consumer financial laws that will transfer to the Bureau's jurisdiction are: Alternative Mortgage Transaction Parity Act of 1982; Consumer Leasing Act of 1976; Electronic Funds Transfer Act; Equal Credit Opportunity Act; Fair Credit Billing Act; Fair Credit Reporting Act; Homeowners Protection Act of 1998; Fair Debt Collection Practices Act; Home Mortgage Disclosure Act of 1975 (HMDA); Home Ownership and Equity Protection Act of 1994 (HOEPA); Real Estate Settlement Procedures Act of 1974 (RESPA); SAFE Mortgage Licensing Act; Truth in Lending Act (TILA); Truth in Savings Act; and the Interstate Land Sales Full Disclosures Act. This is in addition

<sup>8</sup> *Id.* § 1027.

<sup>9</sup> *Id.* § 1022(b)(3)(A). In making such an exemption, the Bureau is to consider the total assets of the class of the covered entity, the volume of consumer financial transactions the class engages in, and whether the product or service offered by the class is otherwise regulated under another law that provides consumers with adequate protections. *Id.* at § 1022(b)(3)(B).

<sup>10</sup> *Id.* § 1027(a)(2)(E).

<sup>11</sup> *Id.* § 1022.

to the authority given to the Bureau through the Dodd-Frank Bill to issue regulations to prevent unfair and deceptive acts and disclosures related to consumer financial protection products and services.<sup>12</sup>

When engaged in rulemaking, the Bureau must abide by specific standards. Specifically, the Bureau is instructed to consider the potential cost of any rule both to consumers and to covered persons; the impact of the rule on small institutions; and the impact of the rule on consumers in rural areas.<sup>13</sup> Importantly, the newly-created Council of Systemic Risk has veto power over any rule prescribed by the Bureau if the Council believes the rule threatens the safety and soundness of the U.S. banking system or economy as a whole.<sup>14</sup>

There are three potential ways for Attorneys General to play a role in the Bureau's rulemaking process: (1) compelling the Bureau to engage in rulemaking, (2) petitioning the Bureau to engage in rulemaking, and (3) commenting on proposed rules.

### *Compelling the Bureau to engage in rulemaking*

Section 1041 of the Act sets forth a mechanism that will allow States to compel the Bureau to engage in rulemaking in certain situations. Specifically, the statute provides that “[t]he Bureau shall issue a notice of proposed rulemaking whenever a majority of the States has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau.”<sup>15</sup> This state-led regulation is apparently unique in administrative law and does not have any federal precedent. However, the language of the Act does provide some guidance on how states can trigger Bureau action.

The first step in the process is for a majority of the states to enact a resolution that deals with consumer financial protection. The use of the phrase “enacted a resolution”<sup>16</sup> implies that the process is triggered only by official legislative action from a majority of States. The resolution could take the form of a joint policy statement, declaration, or request for the Bureau to implement a particular consumer protection rule. By specifying that it be “a resolution” from the states in support of a rule, it likely means that the states must actually submit a joint request to the Bureau—it may not be enough that a majority of states have passed legislation on a specific consumer financial protection issue.

After a majority of the States has acted, the Bureau must engage in drafting proposed rules for a notice and comment period. During this process, the statute requires that the Bureau consider the matter from several different perspectives: (1) whether the proposed regulation will actually provide greater consumer protection than any existing regulation; (2) cost-benefit analysis regarding intended benefit to consumers versus cost or inconvenience for consumers; (3) whether the regulation would discriminate against any class of consumers; and (4) the advice of a Federal banking agency regarding risk to “insured

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<sup>12</sup> *Id.* § 1031.

<sup>13</sup> *Id.* § 1022 (a)(2).

<sup>14</sup> *Id.* § 1023.

<sup>15</sup> *Id.* § 1041 (c). “Consumer protection regulation” is defined as “a regulation that the Bureau is authorized to prescribe under the Federal consumer financial laws.” § 1041 (c)(6)

<sup>16</sup> “Enact:” To establish by law; to perform or effect; to decree.’ Ballentine Law Dictionary. “Resolution:” An expression of the opinion or mind of a municipal counsel concerning some matter of administration and providing for the disposition thereof, being less formal than an ordinance and requiring no set form of words. An expression of any legislative department of government other than by statute.” Ballentine Law Dictionary, citing *Sawyer v Lorenzen*, 149 Iowa 87, 127 NW 1091.

depository institutions.”<sup>17</sup> As much as possible, the State legislatures’ resolution should include significant analysis in these areas to effectively support their proposal.

Despite providing significant power to the States to compel agency action, Section 1041 leaves ultimate discretion to pass a regulation with the Bureau. The Section states that “whenever the Bureau determines not to prescribe a final regulation,” it must publish an explanation of this determination in the Federal Registrar and provide a copy to each State that passed a supporting resolution.<sup>18</sup>

State Attorneys General play a critical role in this process. In many states, the Attorney General takes consumer complaints directly from citizens and can compile firsthand information on consumer needs that may not be available to the Bureau. Attorney General Offices around the country can easily coordinate and collect metadata on local and statewide threats to consumers. The Attorneys General can bring the problem to the State Legislatures’ attention and are in the best position to coordinate action across at least twenty-six states to achieve the majority needed to compel the Bureau to act.

### *Petitioning the Bureau to engage in rulemaking*

Short of meeting the requirements to compel the Bureau to act, States also have the ability to petition the Bureau to engage in rulemaking.<sup>19</sup> The process for petitioning an agency to engage in rulemaking itself will be set forth in an agency rule. At this time the details of the process have not yet been established but it is an issue the Presidential Initiative Working Group will discuss with the agency.

### *Commenting on proposed rules*

Once proposed rules have been promulgated by the Bureau, an Attorney General or group of Attorneys General may provide comments to the agency on the proposed rules. The process for doing so is generally provided in the commentary published along with the proposed rule in the *Federal Register*.

## **Enforcement and Supervision**

The Bureau, and as discussed later, the State Attorneys General, will have a number of tools available at its disposal to enforce the consumer financial protection law and regulations afforded by the Dodd-Frank Act. The Bureau will have investigatory tools, including the power to compel documents and testimony by issuing a subpoena.<sup>20</sup> The Bureau will also have potential remedies available for violations of Federal consumer financial protection law, including administrative cease-and-desist-orders, legal and equitable relief, rescission and reformation of contracts, monetary relief, and civil penalties. However, this enforcement authority only extends to large banks (institutions with assets totaling over \$10,000,000,000)

17 *Id.* § 1041(c)(2). The Bureau must also a discussion of these considerations when it publishes the final regulation in the Federal Registrar.

18 *Id.* § 1041(c)(3)(B).

19 *See Id.* at § 1041 (c)(4), which states that “[n]o provision of this subsection shall be construed as limiting or restricting the authority of the Bureau to enhance consumer protection standards established pursuant to this title in response to its own motion or in response to a request by any other interested person.”

20 *Id.* § 1052 (b).

and non-monetary institutions.<sup>21</sup> Enforcement authority over small banks (institutions with assets totaling less than \$10,000,000,000) remains with the respective prudential regulator.<sup>22</sup>

Supervisory authority over these institutions is similarly bifurcated. For non-depository institutions, the Bureau will have supervisory authority. For large banks, the Bureau will have simultaneous supervisory authority along with the prudential regulator.<sup>23</sup> As to both large banks and non-depository institutions, this supervisory authority will allow the Bureau to request reports and conduct examinations to ensure compliance with Federal financial consumer law. The Act does require the Bureau to coordinate, where appropriate, with any prudential regulator and/ or the Federal Trade Commission to minimize the burden placed on these institutions.

For small institutions and credit unions, primary enforcement and supervisory authority is retained by the Federal Deposit Insurance Corporation (FDIC) for nationally-chartered institutions and State banking and credit union regulators for state-chartered institutions.<sup>24</sup> However, the Bureau does have authority to request a report from the regulator and provides authority for the Bureau to notify the appropriate regulator for appropriate action if it knows of a material violation of a Federal consumer financial protection law.

## **ATTORNEYS GENERAL ROLE IN ENFORCING FEDERAL CONSUMER LAW**

The Dodd-Frank Act preserves the crucial role that State Attorneys General have in protecting consumers from financial fraud and abuse not only by preserving state laws that are more stringent, but also by authorizing Attorneys General to enforce Federal consumer financial protection laws and regulations. The Act provides that the “attorney general. . . of any State may bring a civil action in the name of such State in any district court of the United States in that State or in State court that is located in that State that has jurisdiction over the defendant, to enforce provisions under this title or regulations issued under this title , and to secure remedies under provisions of this title or remedies otherwise provided under other law.”<sup>25</sup> This language suggests that Attorneys General will be able to step into the shoes of the Bureau in enforcing Federal consumer financial protection law, with the same investigatory tools and remedies that are available to the Bureau. This authority is limited as to nationally-chartered financial institutions and federal savings associations. As to those entities, State Attorneys General can only enforce regulations promulgated by the Bureau under a provision of Title X of the Act, not the provisions of the Act itself.<sup>26</sup>

Prior to bringing any such action, an Attorney General should first give notice to the Bureau of the intent to initiate the action. The notice should identify the party or parties involved, summarize the facts

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21 This term is to be defined by rule within one year of the transfer date. *See Id.* at § 1024(a)(2).

22 *Id.* § 1026(d). According to the Act, the “prudential regulator” is: (a) for insured depository institutions or their holding companies, the appropriate Federal banking agency, as defined in the Federal Deposit Insurance Act and (b) for credit unions, the National Credit Union Administration. *Id.* §1002(24).

23 *Id.* § 1025(b).

24 *Id.* § 1026(d).

25 *Id.* § 1042 (a).

26 *Id.* § 1042 (a)(2).

giving rise to the alleged violation, and state any need to coordinate the enforcement with another regulator or Federal agency.<sup>27</sup> Notice may be made simultaneously with the initiation of the action in emergency situations. The Bureau has the right to intervene and may remove the action to Federal court if so desired. The Bureau has a right to be heard during the action and can appeal the outcome of the decision.<sup>28</sup>

The Act requires that any monetary civil penalties obtained by the Bureau be deposited into a “Consumer Financial Civil Penalty Fund” within the Federal Reserve. Those funds are then to be made available to consumers that were victims of the violations for which the civil penalties were recovered, or used to fund consumer education and financial literacy programs.<sup>29</sup> Assumedly, if an Attorney General recovered civil penalties for an action pursuant to the Dodd-Frank Act or regulations, those penalties would be required to be deposited in a similar state consumer protection fund.

## COMMUNICATION AND COORDINATION BETWEEN AG OFFICES AND BUREAU

The Bureau is mandated to coordinate with, in addition to Federal agencies, State regulators to “promote consistent regulatory treatment of consumer financial and investment products and services.”<sup>30</sup> Establishing protocol and a plan for coordinated actions and communication is a top priority for this Presidential Initiative. There are several areas of opportunity for communication and coordination between Attorneys General offices and the Bureau.

### Enforcement

Giving the Bureau and Attorneys General, as well as state regulatory agencies, the authority to enforce Federal consumer financial protection law has advantages in leveling the playing field and ensuring that consumers have a clear understanding of the financial products being offered. However, this concurrent jurisdiction also has the potential to create confusion and duplication of effort for agencies as well as industry. A meaningful plan for communication and coordination between the Bureau and States Attorneys General with regard to enforcement actions is essential. Not only will this preserve limited prosecutorial resources, but it will also promote consistency in enforcement among various agencies.

The Presidential Initiative Working Group is in the process of developing principles of agreement around this issue for discussion amongst all stakeholders.

### Data and Information Sharing

One potential area for data sharing between the Attorneys General and the Bureau is around consumer complaints. The Bureau is required to establish a nationwide hotline and website for receiving

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<sup>27</sup> *Id.* § 1042 (b)(1).

<sup>28</sup> *Id.* § 1042 (b)(2).

<sup>29</sup> *Id.* § 1017 (d).

<sup>30</sup> *Id.* § 1015.

consumer complaints regarding financial products and services.<sup>31</sup> The complaints will be maintained in a database within the Bureau, which is responsible for responding and tracking the complaints.

The Dodd-Frank Act contemplates a system that could route complaints to State agencies, assuming the State agency has the functional capacity for receiving such complaints and the States have satisfied “any conditions of participation in the system that the Bureau may establish” including appropriate levels of confidentiality. The Bureau is directed to share information about the complaints with Federal and state regulators as appropriate.<sup>32</sup>

The sharing of consumer complaints poses opportunity as well as challenges to some State Attorney General offices. First, the Act requires that the State agency have the functional capacity for receiving such electronic or telephonic complaint. This may require an upgrade in automated systems operated by the States, which may in turn require funding. In order to receive the complaints, the State must be able to keep confidential personally identifiable identification.<sup>33</sup> This may pose a challenge to those States with broad public records laws. Further unanswered questions include whether States will have the ability to or will be required to share their complaints with the Bureau and whether States will have access to complaints from consumers located in other jurisdictions in order to spot trends across the country. Agreement on when and what information will be shared, participation conditions, and protocol for response will be developed jointly between the Attorneys General and the Bureau in the coming months.

Another potential area for data sharing is with respect to the Bureau’s office of research. This office will be responsible for researching, analyzing, and reporting on a number of issues related to consumer finance, including identifying any new trends in industries or products and assessing their impact on consumers; increase in consumer knowledge due to disclosures; and traditionally un-served or under-served communities. Attorneys General offices may want to ensure input and early access into areas of research and findings. Data sharing is another important area in which the Working Group will be developing principles of agreement between the Attorneys General and the Bureau.

## PREEMPTION

### With Regard to Generally Applicable Regulations, the Bureau May Preempt only “Inconsistent” State Laws

The Act encourages state consumer protection divisions and regulators to enforce their own consumer protection laws. In particular the Act codifies the Supreme Court’s decision permitting enforcement of generally applicable state consumer protection laws against national banks in *Cuomo v. The Clearing House*

31 *Id.* § 1013 (b)(3).

32 *Id.*

33 *Id.* The statute does not define “personally identifiable information.” A memo from the US Office of Management and Budget (and subsequently adopted by the National Institute of Standards and Technology) describes personally identifiable information as information “which can be used to distinguish or trace an individual’s identity, such as their name, social security number, biometric records, etc., alone or when combined with other personally identifying information which is linked or linkable to a specific individual, such as date and place of birth, mother’s maiden name, etc.” [http://en.wikipedia.org/wiki/Personally\\_identifiable\\_information](http://en.wikipedia.org/wiki/Personally_identifiable_information)

*Association, L.L.C.*<sup>34</sup> In *Cuomo*, the Attorney General of New York sent letters to several national banks, “in lieu of subpoena,” attempting to procure non-public information about their lending practices to enforce New York’s fair-lending laws.<sup>35</sup> The Office of the Comptroller of the Currency (the “OCC”) and the Clearing House Association, a banking trade group, filed suit to enjoin the New York Attorney General from requesting this information, alleging that the National Bank Act (the “NBA”)<sup>36</sup> preempted “visitatorial” actions by the state.<sup>37</sup> The Court ruled that the OCC preemption over state “visitatorial” action was valid but that preemption did not extend to the state’s enforcement of non-preempted laws. The Supreme Court rejected the argument that New York’s fair-lending information requests were “visitatorial” in nature, stating that “[o]ur cases have always understood ‘visitation’ as this right to oversee corporate affairs, quite separate from the power to enforce the law.”<sup>38</sup> Thus, the *Cuomo* decision allowed the enforcement by states of state laws of general applicability, including consumer protection laws.

The Act not only codifies *Cuomo*,<sup>39</sup> but also goes further by stating that nothing in Title X of the Act, except for provisions in Sections 1004 through 1008,<sup>40</sup> “may be construed as annulling, altering, or affecting, or exempting any person subject to the provisions of this title from complying with, the statutes, regulations, orders, or interpretations in effect in any State, except to the extent that any such provision of law is inconsistent with the provisions of this title, and then only to the extent of the inconsistency.”<sup>41</sup> In other words, the Act does not limit consumer protection actions to the Bureau’s provisions, rules, and regulations but rather allows the individual states to pursue state consumer protection acts so long as they are consistent with the Act and rules promulgated by the Bureau. The Act gives individual states further ability to enact and enforce consumer protection laws by explicitly stating that state laws providing greater protection than the protections provided by the Act and Bureau rules are not “inconsistent” solely because they offer greater protections to consumers.<sup>42</sup>

Thus, states are free to enforce all generally applicable consumer protection laws against financial firms, including laws that provide protections to consumers greater than what the Act provides, as long as those laws are consistent with the Act. This new empowerment allows states to retain the autonomy and authority to enact consumer protection laws to the standards they feel necessary without any automatic imposition of an enforcement ceiling provided by the Act or the Bureau’s rules or regulations.

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34 *Cuomo v. The Clearing House Association, L.L.C.*, 129 S.Ct. 2710 (2009).

35 *Id.* at 2714.

36 National Bank Act, 12 U.S.C. 21, *et. Seq.* (1864).

37 *See* *Cuomo*, 129 S.Ct. 2710 (2009). Specifically, the OCC and Clearing House Association cited to 12 U.S.C. 484(a). This section states that “[n]o national bank shall be subject to any visitatorial powers except as authorized by Federal law, vested in the courts of justice or such shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.” *Id.* The OCC argued that this provision preempted New York’s actions. “Visitatorial” powers include examination of a bank, inspection of a bank’s books and records, regulation of activities authorized pursuant to federal banking law, and enforcing compliance of applicable federal or state laws concerning those activities. *12 C.F.R. § 7.4000.*

38 129 S.Ct. at 2716.

39 § 1047, 124 Stat. 1376.

40 *Id.* *See, infra* Section II. Sections 1044 through 1048 relate to preemption provisions in regard to actions against national banks and thrifts.

41 § 1041(a), 124 Stat. 1376.

42 § 1041(a)(2), 124 Stat. 1376.

## With Regard to Banking Regulations, the Act Alters the Status Quo by Requiring a Presumption that State Rules May be Enforced Against National Banks and Thrifts

Prior to the Act, bank regulators had issued broad regulations that preempted state banking laws in a variety of areas, including lending, accepting deposits, and banking generally. The Office of Thrift Supervision (the “OTS”) and the OCC enacted regulations, under the NBA and the Home Owner’s Loan Act (the “HOLA”)<sup>43</sup>, that provided “field preemption” over national banks and national thrifts.<sup>44</sup> Thus, prior to the Act, most state banking laws were preempted with regard to national banks and their subsidiaries, which constituted the vast majority of all banks. The Act does not eliminate preemption of state actions against national banks and thrifts, but it does codify a standard by which state actions are tested to determine preemption, and in so doing<sup>45</sup> shifts the presumption regarding preemption in *favor* of state banking regulations.

### The Act Adopts the Barnett Standard To Determine Preemption of Bank-Specific Regulations

The preemption standard set forth in the Act is based on the Supreme Court’s decision in *Barnett Bank v. Nelson*.<sup>46</sup> In *Barnett*, the Supreme Court was forced to decide “whether or not a federal statute that permits national banks to sell insurance in small towns pre-empts a state statute that forbids them to do so.”<sup>47</sup> The Court observed that many different standards can apply to preemption questions, but concluded that<sup>48</sup> “[i]n this case we must ask whether or not the Federal and State Statutes are in ‘irreconcilable conflict.’”<sup>49</sup>

Using the “irreconcilable conflict” test, the Court used two main factors to find that the federal statute preempted the state statute. First, the federal statute’s provision that a national bank “may . . . act as the agent” for the sale of insurance constituted broad permission for national banks in small towns to sell insurance.<sup>50</sup> Second, the federal statute stated that the grant of authority to sell insurance was “in addition

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43 12 U.S.C. §1461 *et. seq.*

44 *See* 12 C.F.R. § 560.2; § 7.4000-7.4009; and § 34.4.

45 § 1046, 124 Stat. 1376. The Act outlines the preemption standards for federal savings associations by stating that all preemption determinations for actions against savings associations and their subsidiaries “shall be made in accordance with the laws and legal standards applicable to national banks.” *Id.* Thus, for the remainder of this essay, analysis will be limited to preemption standards for actions against national banks.

46 *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).

47 *Id.* at 27.

48 *Id.* at 31. “Sometimes courts, when facing the pre-emption question, find language in the federal statute that reveals an explicit congressional intent to pre-empt state law. More often, explicit pre-emption language does not appear, or does not directly answer the question. In that event, courts must consider whether the federal statute’s ‘structure and purpose,’ or nonspecific statutory language, nonetheless reveal a clear, but implicit, pre-emptive intent. A federal statute, for example, may create a scheme of federal regulation ‘so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.’ Alternatively, federal law may be in ‘irreconcilable conflict’ with state law. Compliance with both statutes, for example, may be a ‘physical impossibility;’ or, the state law may ‘stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” *Id.* (citations omitted).

49 *Id.*

50 *Id.* at 32.

to the powers now vested by law in national banks.”<sup>51</sup> The Court observed that the history of judicial understanding of the “powers” of national banks is “one of interpreting grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law.”<sup>52</sup> Many prior decisions dealing with preemption and national banks “take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of power that Congress explicitly granted.”<sup>53</sup> However, “[t]o 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.”<sup>54</sup> Thus, using the “irreconcilable conflict” standard, the Supreme Court held that the state’s prohibition on the sale of insurance by national banks was preempted but reiterated that states can regulate national banks so long as their regulation does not “prevent or significantly interfere” with the national bank’s exercise of its powers.

The Act relies heavily on the *Barnett* case to establish when state laws and actions against national banks are preempted. Under the Act, state consumer financial laws against national banks are preempted “only if” (a) application of the state law would have a discriminatory effect on national banks when compared to the effect on state chartered banks; (b) “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* . . . the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers”; or (c) the state consumer financial law is preempted by a federal law other than the Act.<sup>55</sup> The determination of preemption under parts (a) and (c) above will be relatively straightforward, but conflict preemption under part (b) will be less definite and will likely result in litigation to determine if state laws “prevent or significantly interfere” with a national bank exercising its powers.

There are two important facets of the Act’s adoption of the *Barnett* standard that will assist states in being more successful in preemption disputes. First, the adoption of the *Barnett* standard makes every preemption decision a “conflict” decision, rather than a “field preemption” decision, and thus narrows the possible theories that proponents of preemption may pursue. Second, by providing that state laws are preempted “only if” they fall into one of the three categories enumerated above, Congress has established a presumption *against* preemption. This amounts to a substantial change because, prior to the Act, courts hearing national banks’ challenges to state banking regulations frequently presume state laws to be invalid.<sup>56</sup> This presumption in favor of preemption yielded preemption of state laws regulating the business of banking even when there was no apparent conflict with federal law or national bank powers. Now, under the Act, the burden is placed on the proponents of preemption to establish that the state law discriminates against national banks, conflicts with national bank powers, or is preempted by some other federal statute.

The adoption of the *Barnett* standard will not prevent the preemption of state actions against national banks, but it does establish a standard by which banks will bear the burden of explaining why they should not have to abide by individual state laws.

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51 *Id.*

52 *Id.*

53 *Id.* at 33.

54 *Id.*

55 Dodd-Frank Act § 1044.

56 Linda Singer et al., *Breaking Down Wall St. Financial Reform: A Summary of the Major Consumer Protection Portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.*, *Journal of Consumer & Commercial Law*, Vol. 14, Num. 1 at 10.

## Determinations of Preemption and Review of Those Determinations Possess More Strenuous Requirements

The Act not only shifts the presumption regarding preemption of state banking law to favor state regulation, but also provides specific direction and standards by which the OCC and the judiciary are to make preemption determinations. Any preemption determination “may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law.”<sup>57</sup> The codification of the case-by-case determination requirement stands in stark contrast to the general “field preemption” favored and employed by the OTS and the OCC prior to the Act. The case-by-case approach to preemption affords states the opportunity for a more narrowly focused and thoughtful review of their statutes and it forces national banks to pursue challenges to individual state statutes rather than rely on broad preemption decrees. Indeed, because this provision forces individual review of each state statute that is challenged on preemption grounds, it underscores Congress’s intention that fewer state laws be preempted.

The Act does leave open the possibility that the Comptroller can preempt multiple states’ statutes in certain circumstances. The Act allows the Comptroller to make preemption determinations both on the impact of the law in question as well as “the law of any other State with substantively equivalent terms.”<sup>58</sup> Thus, in determining whether a state law is preempted, the Comptroller may also include within the ambit of decision all “substantively equivalent” laws of other states.<sup>59</sup> This power to make narrow preemption decisions that apply nationally is reasonable because it would waste resources to perform 50 case-by-case determinations on substantially equivalent laws. Even here, however, the Comptroller cannot make a national preemption determination without first consulting with, and taking into account the views of, the Bureau. This provides an important check on the ability of a single federal official to interfere with the application of state law.<sup>60</sup>

In cases where OCC has decided to preempt state banking laws as applied, the Act establishes a rigorous standard of review. “A court reviewing any determinations made by the Comptroller regarding preemption of a State law by this title . . . shall assess the validity of such determinations, depending upon the thoroughness evident in the consideration 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.”<sup>61</sup> Further, the Comptroller may not make a decision that a state law is preempted unless “substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision” in accordance with the *Barnett* standard.<sup>62</sup> These two provisions require a stringent standard of proof that national banks and other preemption advocates must meet to justify a preemption finding by the Comptroller that can withstand appeal. The standard for judicial review of preemption decisions further tips the scales away from preemption and allows states greater leeway in enforcing their own laws against national banks.

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57 Dodd-Frank Act § 1044.

58 *Id.*

59 Of course whether the language of different state statutes is “substantively equivalent” is likely to be frequently litigated.

60 *Id.*

61 *Id.*

62 *Id.*

In addition, even valid preemption decisions are not final and binding indefinitely; rather they are subject to periodic mandatory administrative review, with the possibility for judicial review of each such periodic administrative determination. “The Comptroller of the Currency shall periodically conduct a review, through notice and public comment, of each determination that a provision of Federal law preempts a State consumer financial law.”<sup>63</sup> OCC must review a decision preempting state law within five years of the decision, and must do so again at least once during each five year period thereafter. In connection with each review, the OCC must, after reviewing any public comments, “publish a notice in the Federal Register announcing the decision to continue or rescind the determination or a proposal to amend the determination.”<sup>64</sup>

This review provision requires the OCC to monitor the financial sector continuously and to examine and weigh the consequences of the Comptroller’s previous preemption decisions. The public comment period for each periodic review will allow states to advocate for reversing prior preemption decisions without the need to initiate entirely new rule-making proceedings or file additional court actions. The review of prior decisions could prove to be a battle ground between states and national banks on the preemption issue with the appointment of new Comptrollers over time. Even if prior preemption determinations are not altered or reversed, the periodic review mandated under the Act will keep states (and their legislatures) aware of the current preemption landscape and assist them in formulating laws that avoid federal preemption.

Another provision that will assist state legislatures in drafting state laws enforceable against national banks without fear of preemption is the requirement that the Comptroller publish and update a list of preemption determinations, no less frequently than quarterly, that “identifies the activities and practices covered by each determination and the requirements and constraints determined to be preempted.”<sup>65</sup>

## **Wachovia Reversed; National Bank Subsidiaries and Affiliates No Longer Enjoy National Bank Treatment**

In *Watters v. Wachovia Bank, N.A.*,<sup>66</sup> the Supreme Court extended broad preemptive regulations implementing the NBA and the HOLA to cover operating subsidiaries of national banks. The Court held that the NBA protects from “state hindrance a national bank’s engagement in the ‘business of banking’ whether conducted by the bank itself or by an operating subsidiary, empowered to do only what the bank itself could do.”<sup>67</sup>

The Act, however, expressly reverses the *Wachovia* decision and provides that “a State consumer financial law shall apply to a subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank) to the same extent that the State consumer financial law applies

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63 *Id.*

64 *Id.* The Act further requires the Comptroller of the Currency to report the findings of these reviews to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, including determinations on whether or not the OCC will continue, rescind, or propose amendment to its previous findings. *Id.*

65 *Id.*

66 *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007).

67 *Id.* at 21.

to any person, corporation, or other entity subject to such State law.”<sup>68</sup> Banks may choose to eliminate these subsidiaries and affiliates, they may charter them as a branch (and therefore afford them the same preemptive standards outlined above), or they may continue employing the subsidiaries with the knowledge that the law of the state in which the subsidiary is located applies. Regardless, the reversal of *Wachovia* is another indication by Congress that individual states should have more authority to enforce their laws against national banks and bank subsidiaries that violate them.

## Conclusion

The Dodd-Frank Wall Street Reform and Consumer Protection Act will have a major impact on the financial services industry, especially with respect to enforcement of state laws against national banks. The Act’s codification of *Cuomo* and *Barnett* signals Congress’s favor of state law enforcement and its intention to allow more regulation of national banks by the states. It permits federal preemption only of inconsistent state statutes and thereby allows states to enact and enforce tougher banking standards. The creation of a protective floor rather than a ceiling at the federal level has the potential to significantly change the authority of State Attorneys General in protecting consumers.

Further helping states is the Act’s new preemption review process featuring both a stringent burden of proof and a rigorous standard of judicial review. With Dodd-Frank, states are likely to be much more successful in sustaining actions against national banks and protecting their consumers through state law enforcement. Further, the Act’s overturning of *Wachovia* may encourage states to challenge previous cases involving preemption of state law enforcement. Dodd-Frank has drastically changed the financial regulatory landscape to favor state regulatory interests and consumer protection efforts.

## NEXT STEPS

Many Attorneys General have already begun the process of developing relationships with officials in the Treasury Department that are overseeing creation of the Bureau. Over the coming months, the NAAG Presidential Initiative Working Group will be developing consensus principles and protocol in order to formalize the relationships between our offices and the new agency. Our initial areas of concern are (1) data sharing, (2) coordination of enforcement, and (3) preemption. The Working Group has also volunteered to serve as a state sounding board for the new agency as it begins implementing its structure. We welcome all states to participate in this effort. Please contact Jennifer Epperson or Al Ripley in the North Carolina Attorney General’s Office if you are interested. Jennifer can be reached at (919) 716-6412 or [jepperson@ncdoj.gov](mailto:jepperson@ncdoj.gov) and Al can be reached at (919) 716-6023 or [aripley@ncdoj.gov](mailto:aripley@ncdoj.gov).

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68 Dodd-Frank Act § 1044(a), 124 Stat. 1376.