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GUEST COMMENTARY

THE CRA AND LOCAL LAWS: NEW YORK CITY'S RBA FALLS TO PREEMPTION CHALLENGE

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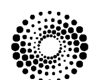
New York City banks are breathing a sigh of relief after a federal judge ruled that they would not have to provide detailed servicing disclosures under a preempted city law. The law, a gloss on top of the federal Community Reinvestment Act of 1977, would have required additional disclosures compared to what the banks already must provide, leaving the banks feeling more than a little exposed to the cold eye of public scrutiny.

U.S. District Judge Katherine P. Failla offered a welcome respite from the August heat of increasing regulation on Aug. 7, 2015[1] when she ruled in favor of the New York Bankers Association. The court held that City Local Law 38 (2012), entitled the Responsible Banking Act, is preempted by state and federal law. While the city tried to characterize the law as simply a way to gather information, the court exposed the city's primary purpose as an improper effort to regulate the banks.

This article provides a brief overview of the federal CRA and the New York RBA, summarizes the arguments and grounds for preemption relied upon by the court, and looks at the potential impact of the ruling on similar city ordinances around the country.

THE FEDERAL CRA

In an effort to encourage more local investment, Congress passed the CRA almost 40 years ago. A 2-year Banking Committee study uncovered a national trend of "redlining" — a practice whereby banks would seemingly draw "red lines" around population areas where they considered residents to be bad bets for loans. Banks may have received deposits from residents in these areas, primarily people with low and moderate incomes, but the banks would refuse to extend them credit, regardless of the applicant's individual



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qualifications.[2] The study found that in Brooklyn, for example, only about 11 percent of local deposits were being reinvested back into the community.[3]

To extend greater credit access to people in these areas, the CRA encouraged banks to reinvest a portion of their lending capital in these communities. The banks then disclose high-level information related to these efforts to their regulators — the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency — which conduct regular reviews to determine compliance. There are no direct penalties for non-compliance, but the regulators publish rankings of the banks' efforts — "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial Noncompliance." A poor ranking can negatively affect whether the bank will win federal approval in other business activities, by, for example, requiring at least a "Satisfactory" rating to establish a new interstate branch or to proceed with a contemplated bank merger transaction.

THE RISE OF *INNER CITY PRESS* AND SIMILAR CRA WATCHDOGS

Armed with the data required by the CRA, a cottage industry of consumer advocacy groups grew up to fight predatory lending and to oppose merger deals involving banks/thrifts with questionable lending records. One of the more active of the groups, resident in New York City, is the *Inner City Press,* headed by Matthew Lee. *ICP* has formerly protested hundreds of proposed bank merger deals across the years and has marshaled CRA data, as well as Home Mortgage Disclosure Act data, to negotiate commitments from banks to promote both the *ICP's* activities as well as community development/access to credit objectives.

Lee founded the Inner City Public Interest Law Project in 1998, expanding it nationally. The organization challenged banks through the regulatory process using the CRA. Based on the CRA, regulators establish a comment period, accepting and considering public comments on merger applications.

The comment period is critical for banks, which desire expedited review and approval, but substantive issues raised and documented can lead to a longer and more high-profile review. The *ICP* program is two-fold. First, it uses its understanding of the banking industry to make banks responsive to low-income communities. *ICP* also analyzes the application process for bank mergers, compiles convincing data on redlining, issues briefs, proposes rules, and files petitions on behalf of the local community group. Second, it mobilizes the communities involved, uses the press and organizes hearings to bridge the inner-city constituency with the banking community.

Since its founding, the organization claims that its work has resulted in $10 billion in new lending commitments throughout the U.S., specifically in Delaware, Wisconsin, Texas, New Mexico and New York City. Information can indeed be powerful.

THE NEW YORK RBA

Enacted in June 2012 by the New York City council, the RBA was never enforced by former Mayor Michael Bloomberg, who disapproved of the law and refused to implement it. The banks challenged the statute in October 2013, but the court dismissed the first case for lack of standing. It was not until current Mayor Bill de Blasio came to office, who championed the law, that the banks faced enforcement.

The statute went far beyond the types of data required to be disclosed at the federal level, by asking for detailed servicing information. As described by the court, "The Needs Assessment noted particular categories as to which it was believed the [Community Investment Advisory Board] would need to collect information not available under the Federal CRA, including: depository banks at the census tract level, multi-family loan portfolios, mortgage loan modifications, servicing of distressed mortgages, foreclosure prevention initiatives, and financial products for low to moderate-income residents."[4]

The RBA created the CIAB to determine low- and moderate-income neighborhoods' financial needs and to set benchmarks that had to be met by the city's depositories. As part of this process, the advisory board would conduct public hearings in each borough,

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which it incorporated into a published report evaluating the banks' performance compared to the benchmarks and best practices. That report could determine whether those banks could receive some of the New York City's $6 billion in deposits.

Under the statute, banks would have had to start providing the required disclosures to the CIAB beginning on Aug. 11, 2015. At the hearing on the NYBA's motion, Judge Failla commented that she was well aware of the impending date and was determined to get her ruling out in advance so the banks would know whether they would have to comply.

HEAVY BURDEN TO BEAR

The NYBA argued that the text of the law showed that it was designed to control banks' conduct and hold the banks "accountable" for their actions in the community. The group is composed of more than 150 commercial banks and federal savings association members across the state, including 17 of the 25 designated banks that can hold New York City's deposits. The NYBA also argued that the RBA's disclosure requirements went well beyond those of the federal CRA and included confidential and proprietary information that could be publicly released as part of the CIAB's report on the Department of Finance's website.

Next, the NYBA argued that the CIAB's evaluation and report of the depositories, which could determine whether they could receive a share of the city's deposits, was effectively a debarment — or exclusion from doing business with the city. Even if not debarred, a negative stigma would likely arise if a bank failed to report or reported problematic data.

Disclosure would also dramatically increase the costs of compliance by having to collect and provide such detailed information.

WATCHFUL EYE

The city argued that the RBA's purpose was simply to gather data for planning, transparency, and policymaking. The statute was to give the city and its residents more information about which banks are doing the most work in the worst neighborhoods across the five boroughs. After having bailed out the banks with taxpayer money, the city felt entitled to obtain such information from the banks to keep a watchful eye on municipal deposits and to ensure the banks were giving back to the communities that helped save them from ruin.

The city rejected the NYBA's assertions of costly compliance, saying such arguments were "self-serving" and "conclusory," arguing that the banks already provided similar information under the federal and state CRAs. The city also asserted that there was no threat of debarment from receipt of city deposits in the statute — at most, the banks would face public ridicule, which the city argued was not enough to qualify as regulation. Any determination that they were no longer authorized to receive municipal deposits would be made by an independent agency, not the CIAB.

The court took an extensive look at the legislative history of the RBA, however, and discovered that the New York City Council repeatedly tied the evaluations and rankings under the RBA with the depositories' qualifications to receive a share of the city's deposits.

PATH TO PREEMPTION

There is a general presumption that federal law will not preempt state or local law. There are three avenues, however, by which the presumption does not apply and a federal statute can preempt a state or local statute: (1) "where Congress has expressly preempted state [or local] law"; (2) "where Congress has legislated so comprehensively that federal law occupies an entire field of regulation and leaves no room for state [or local] law"; or (3) "where federal law conflicts with state [or local] law."[5]

The court recognized that federal banking has been a prime example of the second method, in which the presumption against federal preemption disappeared based on the long history of the federal government's regulation of the field.[6] The court also found that there was a direct conflict between federal law and the local RBA. The court looked first to the National Bank Act, which prohibits the states from exercising visitorial powers over national banks. Such powers include:

- Examination of the banks.
- Inspection of the banks' books and records.
- Regulation and supervision of activities authorized or permitted pursuant to federal banking law.
- Enforcement of compliance with any applicable federal or state laws concerning those activities.[7]

The court agreed with the banks that the RBA attempted to wrest from the federal government the power to examine the banks and to inspect the banks' books and records. The court likewise found that the RBA was in direct conflict with the federal CRA because the RBA imposed greater burdens, focused on more detailed data, and employed a public shaming and disqualification protocol for non-compliant banks.

The court also determined that New York State law likewise preempted the RBA with respect to

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state-charted banking organizations under the New York Banking Law. As with federal law, the NYBL provided both field and conflict preemption.

REGULATORY OR PROPRIETARY?

Only if the state or local law is "regulatory," however, may one of the preemption doctrines apply. The "regulatory" versus "proprietary" inquiry is two-fold: (1) "Does the challenged action essentially reflect the entity's own interest in its efficient procurement of needed goods and services," as compared to the normal behavior of private parties in similar circumstances; and (2) is the scope of the challenged action narrow enough to overcome an inference that its primary purpose was to "encourage a general policy rather than address a specific proprietary problem."[8]

In looking at the RBA, the court struck down each of the proffered purposes of the RBA, concluding that its objective purpose was to regulate banks. The court determined that the alleged purpose of transparency was a ruse since the RBA and its proponents specifically targeted the City's depository banks, rather than all banks that have to provide information under the federal CRA.

The court similarly found that, with respect to the "planning" goal of the RBA — to the extent that it was not simply a euphemism for further regulation — "the legislative history of the RBA and the spirited debate that ushered it into law belie a purpose so toothless." As the court described:

> The critical distinction here is that Defendants are not attempting to place conditions on deposits or transactions that *the City* makes as a bank customer — *i.e.*, as proprietor — when 'interact[ing] with private participants in the marketplace.' Instead, Defendants purport to place conditions on (or at least set forth criteria for) transactions taking place among other private participants dealing in financial markets far afield from municipal deposit-making.[9]

If the city had wanted to place conditions on the types of banks with which it placed its deposits as a banking customer, it could have done so as a permissible proprietary action. Instead, it tried to use its market force to brow-beat the depository banks into compliance.[10]

WHERE ONE MAY GO, OTHERS MAY FOLLOW

In addition to New York, there are at least twelve other cities with similar types of reinvestment legislation.[11] While New York's was arguably the most stringent given the amount of additional data required and the public nature of the evaluation process, other cities may also have difficulty showing that their ordinances have a proprietary rather than regulatory purpose.[12] Let's take a quick look at these dozen other municipalities with parallel legal requirements to New York's RBA for lenders in their communities.

- *Cleveland.* Viewed by some as the leader in local lending, Cleveland implemented its program over 20 years.[13] Its Reinvestment Review Committee analyzes annual data disclosures from HMDA, small business loans (including the race and gender of owners), multi-family loans, and home equity loans.[14] Banks are also required to submit a written initiative, which is made available for public inspection along with the annual data. They must also swear by affidavit to use best practices with respect to community reinvestment.

The Cleveland committee issues an annual report on which banks are in compliance with the ordinance. If a bank falls out of compliance, it may no longer be eligible to receive the city's deposits. Given the public involvement, written initiative, sworn affidavit and debarment type consequences for non-compliance, Cleveland's ordinance would likely fall to a preemption challenge.

- *Philadelphia.* Over a decade later, Philadelphia followed Cleveland with its own separate qualification process specifically for its depository institutions. These qualifications include reinvestment-related disclosures down to the census-tract level and a reinvestment plan. Banks are required to describe how they will match or exceed the performance of their peer banks, and the oversight body can hold banks accountable for meeting the goals set forth in their plans.[15]

This ordinance does not, however, establish a ranking system, nor does it appear to result in any public report by the city council. Thus, the use of the information is much narrower than compared to New York's RBA, which Philadelphia would likely argue makes its program tied to a permissible proprietary purpose. Therefore, this ordinance has a stronger argument against federal preemption.

- *Pittsburgh.* A scheme similar to New York's RBA is in place in Pittsburgh.[16] The two laws are not identical in the exact type of information collected — the RBA generally asks for more conceptual information whereas the Pittsburgh ordinance asks for exact percentages and dollar amounts. Both, however, demand detailed loan data down to the census-tract level, which a dedicated city agency is to review and evaluate before providing a ranking for each bank. Potential depository

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banks must receive a score of at least three on a scale of one (poor) to five (excellent) to be deemed a qualified depository institution.

The city controller is required to consider the score and qualification as a factor in determining whether or not to continue doing business with the bank. The city is likely to argue this direct link to qualification, unlike the indirect reference in the RBA, shows that the ordinance has a permissible proprietary purpose. Pittsburgh may be subject to a preemption challenge, however, because the connection between the disclosure and ranking requirements does not have a clear link to municipal deposit-making.

- *Boston*. The reinvestment act in Boston was adopted as part of its "Invest in Boston" statute, but its broader application and detailed disclosure requirements leave it vulnerable to a preemption challenge. It applies not only to those banks seeking to become depository institutions, but also "any institution desiring a contract for banking services with the city."[17] Boston's law is also similar to New York's RBA in that it requires data on loan performance, modifications, and foreclosures.

Banks desiring to have a contract with the city for banking services are required to pledge to various reinvestment, non-discrimination, non-predatory, and no-redlining commitments. They must also submit an annual statement of reinvestment goals, which is posted, along with its data, on the city's website. The information is evaluated to develop a score, which is ranked against the bank's peers. The public exposure of the information, the mandatory pledge, and the ranking system make this ordinance ripe for a preemption challenge.

- *Los Angeles*. It would be difficult for Los Angeles to argue that the purpose of its ordinance is proprietary, given its stated intent "to spur community reinvestment by the city's financial institutions and underwriters."[18] Among the additional information banks are required to disclose, which is released publicly on the city website, is the banks' level of philanthropy.

Banks must also provide annual reinvestment goals down to the census-tract level. A city administrative officer will produce a matrix based on the bank data for the city council to consider when approving financial institutions. In sum, Los Angeles could face a serious preemption challenge based on its intent, public exposure of data, and detailed annual goals.

- *San Diego*. The ordinance in San Diego comes with legislative history similar to that of New York's RBA, which makes it vulnerable to a preemption challenge. The City Council president stated in a 2012 press release: "The city's more than $1 billion in annual public tax-dollar deposits should be put into financial institutions that will help keep struggling families in their homes, doors open at fledgling small businesses and investments flowing to rebuild our hardest hit neighborhoods."[19]

The purpose stated in the code seeks to ensure that the banks with which the city does business "are responsive to community needs and seek to promote economic growth and community reinvestment." These statements smack of an effort to use the city's market leverage to achieve a social goal, rather than a proprietary purpose related to its deposits.

- *Chicago*. The requirements that Chicago's ordinance makes for its depository institutions include additional disclosures of loan information, and require the banks to sign a pledge agreeing to avoid predatory lending and not discriminate or redline. There is no separate plan or scoring system, and it does not appear that any of the disclosed information is made public.

Given the limited extent of these requirements, Chicago's ordinance could possibly survive a preemption challenge.

- *Minneapolis*. The broad stated purpose of the Minneapolis ordinance hints of the same purposes asserted by New York's RBA — transparency, planning, and policy-making — thus, making it quite vulnerable to a preemption challenge. Substantively, the law imposes extensive disclosure requirements related to loan modifications and foreclosures and requires a community reinvestment plan every two years, among other information.

If a bank does not provide such information, the city council may refuse to allow the bank to provide any banking services for the city. Given the tie between the broad purposes and the threat of being cut off from providing deposit services to the city, this ordinance would likely not survive a preemption challenge.

POTENTIAL FOR MORE PREEMPTION CHALLENGES

The decision out of the Southern District of New York rejecting the RBA was a positive step in alleviating some of the mounting regulation and disclosures demanded of financial institutions. By recognizing the overlap and proper authority of the state and

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federal governments, consumers are still protected, while banks have one less layer of regulation consuming time and resources.

Other cities with similar laws should beware the implications of Judge Failla's order, as none could easily fend off a preemption challenge. There is a missing link between the imposed disclosure and planning criteria for depository institutions and the affect such criteria ultimately have on municipal deposits. Until that link is provided to bolster the argument that the laws in fact have a proprietary purpose, banks should expect more of these ordinances to fall if challenged by presumption.

The questions remain: Will New York Mayor De Blasio pursue an appeal of the preemption ruling? Will other municipality laws face similar preemption challenges? And, will municipalities tweak their laws in order to strengthen the defenses to preemption?

These regulatory turf battles will continue to play out for the next several years.

Notes

[1] *New York Bankers Assoc., Inc. v. City of New York*, No. 15-04001 (S.D.N.Y., order granting summary judgment 08/07/15) ("Order").

[2] Jonathan Walters, *Pushing the CommunityReinvestment Act into Uncharted Territory*, *GOVERNING* (August 2014) http://www.governing.com/topics/urban/gov-community-reinvestmentact.html.

[3] Eugene A. Ludwig, James Kamihachi, and Laura Toh, *The Community Reinvestment Act: Past Successes and Future Opportunities*, *in COMMUNITY DEVELOPMENT INVESTMENT REVIEW* 84 (Federal Reserve Bank of San Francisco, 2009).

[4] Order, at 35.

[5] Order, at 44 (quoting *Pac. Capital Bank, N.A. v. Connecticut*, 542 F.3d 341, 351 (2d Cir. 2008)).

[6] Order, at 44, 65.

[7] 12 C.F.R. § 7.4000.

[8] Order, at 45-46 (quoting *Healthcare Ass'n of N.Y. State v. Pataki*, 471 F.3d 87, 108 (2d Cir. 2006)).

[9] Order, at 53 (quoting *Sprint Spectrum, L.P. v. Mills,* 283 F.3d 404, 417 (2d Cir. 2002)).

[10] Order, at 53.

[11] These cities ordinances include, in chronological order of implementation: Cleveland, Code §§ 178.04-178.10 (1991); Philadelphia, Code Ch. 19-200, *et seq.* (2002); San Jose, City Council Investment Policy 1-12 § 22.0 (2010); Chicago, Code § 2-32-400, *et seq.*, and Seattle, Code 20.65.010 (2011); Boston, Code § 6-8, *et seq.*; Kansas City, Code § 2-1950, Los Angeles, Ordinance 20.95.1, *et seq.*, Portland, Resolution No. 36926, Pittsburgh, Ordinance § 221.01, *et seq.*, and San Diego, Code § 22.3901, *et seq.* (2012); and Minneapolis, Code 16.110 (2013).

[12] San Jose, Seattle, Kansas City, and Portland are not discussed in this review. They generally all provide that the city may consider the bank's participation in community investment when considering bids for banking services, but they do not have the same extensive disclosure, evaluation, or mandatory criteria as found in the other states.

[13] Yolanne Almanzar, *What Impact Have "Responsible Banking" Laws had Elsewhere?*, *THE NEW YORK WORLD* (May 15, 2012), http://www.thenewyorkworld.com/2012/05/15/the-daily-q-what-impacthave-responsible-banking-laws-had-elsewhere.

[14] Cleveland, Code §§ 178.04-178.10.

[15] Philadelphia, Code Ch. 19-200, *et seq.*

[16] Pittsburgh, Ordinance § 221.01, *et seq.*

[17] Boston, Code § 6-8, *et seq.*

[18] Los Angeles, Ordinance 20.95.1, *et seq.*

[19] Press Release, San Diego City Counsel, "Council President Announces Responsible Banking Ordinance" (May 16, 2012) http://www.sandiego.gov/citycouncil/cd4/pdf/news/2012/120516 bankingordinance.pdf.

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