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Suggested Approaches to Preemption Following the Dodd-Frank Act

With the adoption of the Dodd-Frank Act (Act), many industry commentators have expressed the concern that federal preemption may have suffered a serious (or fatal) setback. In numerous instances, the Act prohibits or reduces the ability of agencies responsible for interpreting federal laws and regulations to preempt conflicting state laws. Moreover, the Act authorizes state attorneys general to directly enforce federal consumer protection laws against national banks and federal savings associations, as well as eliminates the value of operating subsidiaries by specifically making those entities subject to state laws.

This alert provides several observations and suggestions regarding the new preemption landscape—including steps that national banks, federal thrifts and other interstate lenders should consider on a go-forward basis.

Limits on CFPB Preemption Authority

Title X of the Act creates the Consumer Financial Protection Bureau (CFPB), and transfers to it primary regulatory and interpretative authority for virtually all federal consumer protection statutes.

In regard to the consumer laws transferred to the CFPB, in most cases they contain provisions that address the preemptive nature of the laws, and range in nature from providing strong preemption language to a state-favored approach whereby local state laws that provide greater consumer protections are not affected by a federal consumer override. (See, for example, Section 173 of the Truth-in-Lending Act and Section 919 of the Electronic Fund Transfer Act.)

Section 1041 of the Act provides that in its administration of the federal laws transferred to it, the CFPB may not preempt state laws that are *more protective* than a federal consumer law counterpart. Specifically, Section 1041 states that a state's law may only be preempted if it is inconsistent with a federal consumer protection law—but an inconsistency does not include providing greater protection to a consumer.

While this limitation is unfortunate, we do not believe that it will unduly interfere with current federal preemption practice under the federal consumer statutes transferred to the CFPB. We arrive at this conclusion for several reasons. First, from an historical perspective with respect to federal consumer statutes, the federal agencies responsible for enforcement of the specific statutes, such as the Federal Reserve Board's Office of Community and Consumer Affairs, have been reluctant to exercise interpretative authority in a manner that has resulted in specific preemption of state laws. Rather, federal agencies have instead relied upon court proceedings and litigation among private litigants to determine the preemptive effect of federal consumer laws and regulations. (Even in those instances in which protracted and vexatious litigation could have been avoided, the general experience has been that federal agencies have been reluctant to intervene in order to resolve a consumer preemption controversy.)

Second, we note that the preemption limitation imposed on the CFPB described above does not affect the preemptive provisions of the several federal consumer protection laws under its jurisdiction. Rather, the preemption limitation is jurisdictional in nature and merely limits the CFPB from issuing interpretations that would arguably be given *Chevron* deference by the courts. Stated another way, the limitation on the CFPB's preemptive authority will prevent it from directly involving itself in preemption disputes between private parties—which can be viewed as the current status quo. Further, any regulatory actions taken by the CFPB relating to the federal consumer protection statutes under its jurisdiction will still be preemptive vis-à-vis contrary state laws—in accordance with the particular preemption provision of the federal consumer statute.

National Bank and Federal Association Preemption

While the impact of the limits placed on the CFPB's preemption authority may ultimately be found to be minimal, the preemption limitations placed on the OCC regarding national bank preemption are far more complicated and could be very detrimental to an institution's interstate lending and deposit operations. Among other things, this is because, unlike the limited preemptive impact of many federal consumer protection statutes, both the National Bank Act and the Home Owners' Loan Act have been employed with great success by the OCC and the OTS in crafting a lending and deposit structure that has facilitated interstate bank operations by preempting numerous categories of state laws.

The preemption scheme contemplated by Section 1044 *et seq.* of the Act requires the OCC to distinguish between state consumer protection laws and other laws of general applicability. Assuming that such a distinction is possible, the OCC's preemptive authority in the consumer sphere is limited to preempting state laws that: (a) directly discriminate against national banks (which in today's national market is exceedingly rare); (b) are preempted by a federal law that is not part of the National Bank Act; or (c) "prevents or significantly interferes with the exercise by the national bank of its powers." In order to further limit the scope of the OCC's preemptive authority, preemption determinations must be made on a case-by-case basis (although similar state laws would arguably also be preempted), and when considering a preemption determination the OCC will likely consult with state authorities whose law may be preempted. When reviewing any OCC preemption determination, the OCC's views are not afforded *Chevron* deference, and the OCC's determination must be based upon a record that supports the preemption finding.

We offer the following observations: first, although the new preemption consumer preemption scheme appears to be prospective and not retroactive, it is unclear whether existing OCC preemption determinations will remain in effect or whether as of July 21, 2011 (the effective date of the new preemption scheme, termed the "transfer date") the slate is wiped clean. (Note that assets or liabilities originated prior to the effective date of the new preemption requirements may continue to rely upon the current strong federal preemption of the National Bank Act and the HOLA.) We have discussed this issue with representatives of the OCC and OTS, and those agencies have to date declined to indicate how they will address these critical issues.

Second, although the Act states that the new consumer preemption test is the test articulated in the Supreme Court case of *Barnett*

Bank of Marion County, N.A. v. Nelson, 517 US 25 (1996), the judicial precedent and regulatory guidance based upon that decision is not extensive—due in no small part to the promulgation by the OCC of its expansive preemption regulations at 12 C.F.R §§ 7.4006 and 7.4007. Those regulations—which address both the lending and deposit operations of national banks—are based upon a preemption framework in which certain categories of state regulations are specifically preempted.

In regard to consumer laws, it now appears that the current approach of the OCC—a robust form of conflict preemption—will no longer be applicable. In its place the Act has substituted the rule, based on a narrow reading of the *Barnett* case, that a mere conflict is not sufficient to preempt, and that in order to preempt in the consumer context a higher standard is required that finds that the particular state law significantly interferes with a national bank's operations. Stated another way, this new consumer preemption rule may be viewed as having substantially diminished conflict preemption as a tool to be relied upon by national banks and thrifts in the future.

Third, whether or not the OCC elects to clarify the continuing applicability of its existing preemption determinations, the new preemption scheme may significantly diminish the role of the OCC in future litigation involving preemption. This is because the preemption process for consumer issues as contemplated by the Act is protracted and convoluted, and efforts by the OCC to preempt may easily be subject to attack by state consumer advocates. (In addition, the absence of *Chevron* deference afforded to the OCC may result in fewer judicial preemption disputes being resolved at an early stage of the process based upon an OCC preemption determination.)

Finally, even though a national bank or federal thrift retains its ability to adopt a legal position that a state law is preempted, under this new statutory scheme, there may be some reluctance on the part of courts to defer to either OCC or OTS preemption determinations. When coupled with a growing sophistication on the part of state legislatures (through the influence of consumer advocates) to imbed consumer protections into laws of general applicability, national banks and federal thrifts should exercise care in analyzing preemption issues in the near future until answers to these and related concerns emerge.

In the minimum, national banks and federal thrifts may conclude that they will now be required to engage in more extensive state law reviews when developing new loan and deposit products. Procedural and substantive state law requirements heretofore clearly preempted under the National Bank Act and the HOLA must be reconsidered in light of this new consumer preemption scheme. (Whether this ultimately means abandoning a unified interstate lending approach in favor of a more balkanized state-by-state approach remains to be seen.)

We trust that this alert is useful. Please note that this analysis—which is provided for educational and informational purposes—is a summary of legal issues regarding a new and complicated federal approach to preemption as adopted by the Dodd-Frank Act. Careful review of the topics covered in this alert, including on-going developments, is recommended.

About Venable's CFPB Task Force

We are dedicated to providing our thoughts and observations on the CFPB and the impact that its policy determinations will have on the current and long-term businesses of consumer financial product and service providers. Task Force updates and materials can be found at www.Venable.com/cfpb-task-force.

Please note that many of the topics discussed in this alert are summary in nature, and will continue to evolve as the CFPB commences its operations.

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