



Analysis of Senate Version of National Bank Preemption Provision of Wall Street Reform Bill

April 23, 2010

The preemption language in section 1044 of S. 3217, the Restoring American Financial Stability Act, copies the intensely negotiated Bean Amendment from the House bill and gives the Office of the Comptroller of the Currency far *too much power* to preempt state consumer protection laws. The provision should *absolutely not* be weakened any further and needs to be strengthened to permit states to play their crucial role as first responders.

The need to curtail preemption abuses. States adopt laws for a reason: to correct abuses that are not addressed in federal law. They need to address new problems before they spread nationally and catch the attention of federal regulators.

- In 2004, the OCC issued a broad preemption regulation that wiped out all state laws governing the terms of mortgages and other forms of credit. Studies show that states that adopted tough anti-predatory lending laws before that regulation had lower foreclosure rates than states without those laws.
- National banks made riskier loans after preemption was extended. In 2006, from 32% to 50% of toxic loans, depending on the type, were made by banks and subsidiaries that states could not touch, and that share was growing.

Barnett standard: Section 1044 requires the OCC to follow the 1996 Supreme Court case that preempts state law if it significantly interferes with the business of banking.

- Purpose: To ensure that state laws are not preempted unnecessarily.
- Why it's not a problem: The OCC claims it has been following this standard. If a law does not interfere with banking, it shouldn't be preempted.

Case-by-case review. Section 1044 allows the OCC to preempt a particular state law “on a case-by-case basis” or any other law with “substantively equivalent terms.” Courts can also find a law preempted without waiting for an OCC rule.

- Purpose: To ensure that consumer protection laws are not preempted thoughtlessly across the board if they don't have a detrimental impact on the business of banking.
- Why it's not a problem: State laws were always preempted case-by-case until 2004, when the OCC issued a broad preemption regulation. Decisions about one state law will be followed in other states. The importance of protecting consumers and respecting the role of states in our constitutional system outweigh any inconvenience of a case-by-case approach.
- Problem: OCC could misuse the phrase “or the law of any other State with substantively equivalent terms” to deem broad classes of laws to be substantively equivalent. That phrase should be deleted.

Federal substantive law. Section 1044 requires the OCC to find that a federal law “provides a substantive standard” regulating the particular activity subject to the preempted state law.

- **Purpose:** To ensure that state law protections are not wiped out with nothing in their place to replace them. The OCC was less concerned about uniformity than it was in protecting banks from all consumer protection laws, a hostility that continues to this day as the OCC opposed provisions of the Credit CARD Act and a new consumer regulator.
- **Why it’s not a problem:** State laws on new problems not addressed by federal law are precisely the most important ones not to preempt. The OCC must consider whether there is a gap in federal law, but the provision does not prescribe any particular degree of protection. A court concerned about significant interference with banking would find some federal law to meet this standard. State banks do not enjoy preemption, and any law that had serious impacts on banking would be challenged and not survive on a variety of grounds unrelated to preemption or the standards in Section 1044.
- **Why it needs to go farther:** OCC could find that any federal law on a broad topic, such as mortgages, provides a substantive standard regardless whether it deals with the harm that the state law addresses. The federal law instead should provide “sufficient substantive protection to consumers” for the harm at issue.

Respect for the role of states in our constitutional system of federalism and for the importance of consumer protection demand that state laws not be preempted cavalierly. Section 1044 takes very minimal steps in that direction, cannot be further weakened, and needs to be strengthened.

For more information, contact Lauren Saunders, (202) 452-6252 x 105, Lsaunders@nclcdc.org.