WILMER, CUTLER & PICKERING

Financial Institutions Group Newsletter

FEBRUARY 4, 2003

PREEMPTION DEVELOPMENTS

The OTS and OCC have each recently acted to expand the reach of preemption for federally chartered banks and thrifts. The OTS has issued two letters preempting state predatory lending laws, and the OCC has proposed a rule to solidify its expansive reading of its own exclusive visitorial powers. These actions build on recent successes in the *Lockyer* case in California and other decisions upholding federal preemption. The OTS letters are immediately effective, although they suggest the OTS will also be very receptive to additional future requests for preemption of other state predatory lending laws. The OCC action is only the beginning of what will likely be a protracted rulemaking process, in which the active support of the banking industry through comment letters will be crucial.

OTS Preemption of Georgia and New York Laws

The OTS recently issued two opinion letters stating that provisions of recently enacted predatory lending laws in Georgia and New York are preempted. OTS Legal Op. P-2003-1; OTS Legal Op. P-2003-2. In both letters, the OTS opined that applicability of the state laws to federal thrifts would frustrate Congress's intent that the agency have sole regulatory responsibility over the operations of federally chartered thrift institutions.

The Georgia Fair Lending Act

The Georgia Fair Lending Act, to be codified at Ga. Code Ann. § 7-6A-1 *et seq*., imposes an increasing number of restrictions on mortgage loans depending upon whether they are "high-cost" loans (with APRs or points and fees above specified thresholds), "covered home loans" (lower thresholds), or other conforming loans. The GFLA restricts in all home loans the financing of credit insurance or similar products, creditor encouragement of default, late-payment and payoff-statement fees. The statute also prohibits "flipping" a covered loan, which is defined vaguely as a refinancing within five years that does not provide a "reasonable, tangible net benefit to the borrower." On high-cost loans, the GFLA restricts prepayment fees, balloon payments, negative amortization, interest-rate increases after default, advance payments from loan proceeds, fees to modify or defer a payment, accelerating payment at the creditor or servicer's sole discretion, and making such loans without regard for the borrower's repayment ability or without receiving a certificate from a Georgia or HUD-approved non-profit counselor that the borrower has received financial counseling.

The GFLA includes tough provisions on civil liability. It permits borrowers to recover *punitive* damages and subjects purchasers and assignees of high-cost loans to "all affirmative claims and defenses with respect to the loan that the borrower could assert against the original creditor." "Creditor" is defined to include purchasers and assignees.

On January 21, the OTS opined that the parts of the GFLA restricting "the terms of credit, loan-related fees, disclosures, or the ability of a creditor to originate or refinance a loan" are preempted from applying to federally chartered thrifts. The opinion letter stated that sections 3 (prohibited practices in home loans), 4 (prohibition on loan flipping), 5 (limitations on high-cost loans), and 7(f) (prohibiting the

brokerage of a loan violating the act) do not apply to federally chartered thrifts. The OTS reiterated its longstanding position that it "occupies the field to enhance safety and soundness and enable federal savings institutions to conduct their operations in accordance with best practices by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden."

The letter also specifically identified four sections of the law that its "opinion does not address." These are sections 5(6), which prohibits "high-cost" home loans that require borrowers to assert claims or defenses in less convenient forums than where the borrower may typically bring such a claim, and sections 5(11)-(13), which impose a variety of notice and cure requirements for foreclosures of high-cost home loans. The Federal Arbitration Act likely limits the former provision. Notably, the OTS letter also failed to address the law's assignee liability provisions.

The opinion comes hard on the heels of continued withdrawals by lenders and secondary market buyers from the Georgia market. Most importantly, Standard & Poor's announced in mid-January that as of February 1, it would no longer rate any structured finance transaction that included loans subject to the GFLA. S&P cited the difficulty in ensuring that such loans had been originated in compliance with the Act and the possibility of unquantifiable punitive damages being imposed through the law's assignee liability provisions on securitization depositors and trusts. Moody's recently followed suit with a somewhat similar statement. The rating agencies' actions have triggered a flurry of legislative activity in Georgia, as the interested parties try to work out a compromise solution.

The New York Predatory Lending Law

New York's Predatory Lending Law imposes requirements and limitations on high-cost home loans, including restrictions on the following: permissible circumstances for refinancing, lending without regard to repayment ability, payment of referral fees to mortgage brokers, payments from loan proceeds to home improvement contractors, call provisions, balloon payments, negative amortization, default interest rates, modification or deferral fees, advance payments, and financing of single-premium insurance or points and fees; and requirements to report payment history to a credit bureau, for disclosures regarding counseling, pre-closing warnings about foreclosure, a note legend identifying the mortgage as high-cost, and a bar on encouragement of default.

The New York law is less onerous than Georgia's in various respects, notably in that it does not authorize recovery of punitive damages. The law also contains a more narrow assignee liability provision, which by its terms only authorizes a borrower to raise defenses to payment and claims in recoupment against "any *action by an assignee* to enforce a loan." However, the NYPLL's other remedy provisions allow not only consequential and incidental damages, statutory damages, attorney fees, injunctive and equitable relief, but also rescission and, for intentional violations, recovery by the borrower of all payments made and voiding of the lender's right to recover *any* further principal, interest, or other charges. The NYPLL also provides that the defense of rescission and the ability of a borrower to raise claims of recoupment or defenses to payment against an assignee are subject to no time limitation.

The OTS, in opinion letter P-2003-2 dated January 30, 2003, declared that the provisions of the NYPLL described above were preempted for federal thrifts, as well as certain foreclosure provisions that would have required a lender to *affirmatively* prove its compliance with the law to obtain a foreclosure judgment, if such provisions effectively require thrifts to comply with preempted substantive provisions.[1] Again, the OTS declined to address restrictions on mandatory arbitration provisions, as well as certain regulations of home improvement contractors.

Although the New York law is generally less onerous than Georgia's, we expect that there will be considerable momentum for change. We would also expect the OCC to follow the OTS's lead relatively soon. Leaving aside the issue of preemption, the OCC's proposed visitorial powers rule, discussed

1 The preempted provisions of the NYPLL are those to be codified at N.Y. Banking Law §§ 6-1(2)(a)-(f), (h)-(k), (l)(i)-(ii), (m)-(q), 6-l(2-a)(a)-(b), 6-l(5)-(12) and N.Y. Real Prop. Acts. Law § 1302.

below, makes clear the agency's view that the New York Attorney General could not enforce the law against national banks.

OCC Visitorial Powers Rule

12 U.S.C. § 484(a) limits visitorial powers over national banks:

> No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as 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.

The OCC is granted broad visitorial powers over national banks in 12 USC § 481. See also *Guthrie v. Harkness*, 199 U.S. 148 (1905).

On January 31, 2003, the OCC issued a notice of proposed rulemaking setting forth its interpretation of 12 U.S.C. § 484. The preamble to the OCC's proposed rule examines at great length the legislative history of the statute to demonstrate that from the inception of the national banking system, Congress has intended to protect national banks from hostile state regulation. According to the OCC, Congress believed that states would have every incentive to interfere with the actions of national banks and so stripped the states of visitorial powers and vested such authority exclusively in the OCC.

The OCC's proposed visitorial powers rule focuses on two primary questions. First, "what activities conducted by a national bank are subject to the OCC's *exclusive* visitorial powers?" The proposed rule declares that the OCC's authority is exclusive "with respect to activities expressly authorized or recognized as permissible for national banks under Federal law or regulation, or by OCC issuance or interpretation, including the content of those activities and the manner in which, and standards whereby, those activities are conducted."

Second, the OCC asks, "[w]hat is the meaning of certain exceptions to the OCC's exclusive visitorial powers that are provided in the statute, specifically the exception for visitorial powers '*vested in the courts of justice*'?" The OCC reads this exception relatively narrowly, effectively arguing that this provision does *not* authorize a state to bring an action in court to enforce its laws against a national bank, rather it merely permits courts to exercise their traditional discovery powers:

> (2) Exception for courts of justice. National banks are subject to such visitorial powers as are vested in the courts of justice to issue orders or writs compelling the production of information or witnesses. This exception does not authorize state or other governmental entities to inspect, regulate, or supervise the activities of national banks, or to compel production of information or adherence to restrictions or requirements concerning the content of those activities or the manner in which, or standards whereby, those activities are conducted.

The OCC states that the upshot of these new rules is that if a State wants to enforce its laws against a national bank, the State's only option is to sue for declaratory judgment (to establish that the law is not preempted), win, and then wait for OCC enforcement:

> Under this construction of section 484, states remain free to seek a declaratory judgment from a court as to whether a particular state law applied to the Federally-authorized business of a national bank or is preempted. However, if a court rules that a state law is not preempted, enforcement is within the OCC's exclusive purview.

By proposing to enshrine its positions in a notice-and-comment regulation (and base it on a detailed analysis of the statute and its history), the OCC obviously hopes to ensure that its view will receive judicial deference under the Supreme Court's *Mead* and *Christensen* cases. But the OCC's proposal is very likely to create a storm of controversy from States and from plaintiffs' lawyers, and it will probably be productive for national banks to provide supporting comments for the OCC's positions.

Moreover, the proposal leaves open some important points on which the banking industry may want to register its viewpoints. For example, the

passage quoted above states that the OCC envisions that a State may bring a declaratory judgment action in court concerning the applicability of a State statute to a national bank – but it is unclear whether the OCC envisions that the OCC, or a bank itself, is to be the defendant in such an action. Another key point: the proposal states that "state or other governmental entities" are limited in their attempt to "inspect, regulate, or supervise the activities of national banks or compel production of information . . ." but the proposal does not specifically address State suits against national banks that are in the nature of *parens patriae* actions on behalf of citizens. Nor does it address whether a State may "deputize" private citizens to bring such actions on behalf of the general public, in place of State officials themselves. There are important arguments that allowing such suits should be regarded as an impermissible end-around the "visitorial powers" limitations, and submitting comments to the OCC on these issues may be desirable for a variety of reasons.

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The recent OTS preemption letters on predatory lending and the OCC's proposed visitorial powers rule suggest that we should expect increased competition and further developments in the preemption front of the charter wars. If you would like a copy of the OTS preemption letters or the proposed OCC rule or further information regarding them, please contact Chris Lipsett (212/230-8880), Gregory A. Baer (202/663-6859), Franca Harris Gutierrez (202/663-6557), or David A. Luigs (202/663-6451).