

# State Subprime Lending Litigation and Federal Preemption: Toward a National Standard

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## Introduction

Residential Mortgage Backed Securities (“RMBS”) and other structured finance products, such as Collateralized Debt Obligations (“CDOs”) based on RMBS, lie at the heart of the financial crisis, and mortgage lending practices are currently in the crosshairs of state and federal legislators and regulators. On March 5, 2009, the Mortgage Bankers Association (“MBA”) reported that 11.93% of all American mortgages were either in foreclosure or at least one month overdue, the highest percentage rate since the MBA began reporting these figures in 1972.<sup>1</sup> Although the cascade of financial losses has coursed far from the RMBS and subprime sectors, those areas will no doubt remain a focus of attention as mortgage delinquency rates continue to climb. State statutes targeted at subprime lending, created before the current crisis, now co-exist with new Federal Reserve amendments to Regulation Z, under the federal Truth in Lending Act (“TILA”), aimed at the very same market sector. Legal reform efforts will no doubt include an attempt to revive and refashion the mortgage securitization system that created the previously profitable, and now infamously “toxic,” assets. This Article argues that such efforts should include the creation of uniform national standards for mortgage origination and mortgage-holder liability in order to support transparency and predictability in the marketplace.

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1. Press Release, Mortgage Bankers Ass’n, Delinquencies Continue to Climb in Latest MBA National Delinquency Survey (Mar. 5, 2009), *available at* <http://www.mbaa.org/NewsandMedia/PressCenter/68008.htm>.

The dual system of federal and state banking in the United States creates a patchwork quilt of statutes and regulations, issued at both the state and federal level. This system imposes different laws on different banks, even though they may be operating side-by-side. The degree of difference depends not only on whether the financial institutions were created by state or federal law, but also on the specific area of banking at issue. National banks, for example, are generally exempt from state banking-directed regulation as a result of the National Bank Act and other statutes granting banking powers to federally chartered institutions.<sup>2</sup> On the other hand, some of the activities of state-created banks are either partially or exclusively federally regulated. For example, some states are precluded from limiting interest rates on first mortgages, made by virtually any lender, under the Depository Institutions Deregulation and Monetary Control Act (“DIDMCA”).<sup>3</sup> In addition, “alternative mortgage transactions,” i.e., adjustable-rate mortgages (“ARMs”) and balloon payment mortgages are exempt from state law regulations (at least in some states) when used either by state or federally chartered institutions.<sup>4</sup>

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2. See, e.g., National Bank Act, 12 U.S.C. §§ 24 (Seventh), 371, 484 (2006); *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 10-13 (2007); *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 9-10 (2003) (holding that the National Bank Act provides the exclusive cause of action against national banks for usury); *Barnett Bank of Marion City, N.A. v. Nelson*, 517 U.S. 25, 27-28 (1996) (holding that bank's power to sell insurance is protected by federal law); *Franklin Nat'l Bank of Franklin Square v. New York*, 347 U.S. 373, 377-78 (1954) (holding that a state may not prohibit advertising of “savings” account by national bank); 12 C.F.R. §§ 7.4007 (deposit taking activities), 7.4008 (non-real estate lending), 7.4009 (other authorized activities), 34.3-4 (real estate lending) (2009); 12 C.F.R. § 560.2 (2008) (preemption of state regulation of federal savings banks).

3. 12 U.S.C. §§ 1735f-7a(a)(1)-(2) (noting that state laws regarding interest rates do not apply to defined mortgages or to federally regulated banking institutions). The National Housing Act, § 527(b), defines by reference those mortgage loans that are covered by the DIDMCA. 12 U.S.C. § 1735f-5(b). States had the opportunity to opt-out of this blanket preemption regarding interest rates, but only a minority chose to do so. Deanne Loonin & Elizabeth Renuart, *The Life and Debt Cycle: The Growing Debt Burdens of Older Consumers and Related Policy Recommendations*, 44 HARV. J. ON LEGIS. 167, 175 (2007) (citing Elizabeth Renuart & Kathleen E. Keest, *The Cost of Credit: Regulation, Preemption and Industry Abuses* § 3.9.4.1 (2005)).

4. See *Ill. Ass'n of Mortgage Brokers v. Office of Banks & Real Estate*, 308 F.3d 762, 766 (7th Cir. 2002) (holding that federal statute expressly preempts any state law that would prevent a state-licensed lender from making a loan permitted by federal law). The statute, intended to create

Other practices, such as disclosures governed by TILA, are left to the states with regard to institutions organized under state law, so long as state rules do not conflict with federal law.<sup>5</sup>

With respect to subprime lending, aggressive state legislation has created particular uncertainty, with real-world economic effects. For example, Standard & Poor's refuses to rate RMBS containing subprime mortgage pools that originated in certain states.<sup>6</sup> Recent litigation heralds an increasing impact for state subprime lending laws, while inconsistency with federal law grows and preemption issues become more complex.

Under the current system, mortgage market participants and the courts struggle to make sense of the tangle of conflicting laws and regulations. Any reform should involve movement towards uniform national standards for mortgage lending to reduce uncertainty and to foster transparency and predictability in a market sorely in need of both. As set forth below, at a minimum, national banks that hold mortgages, RMBS, and their derivatives should be exempt from state subprime lending laws, which would otherwise impose liability or losses if a national bank holds mortgages running afoul of such state laws.

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uniform rules for state and federal institutions, states: "An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law or regulation." 12 U.S.C. § 3803(c). An "alternative mortgage transaction[ ]" is any mortgage where the finance charge or interest rate may be renegotiated, or where the debt matures at the end of an interval shorter than the amortization schedule (balloon payment), or involving any terms that "involve the sharing of equity or appreciation." *Id.* § 3802(1). *See also id.* § 3802(2) (defining "housing creditors" as all lenders except unlicensed, unchartered entities). States also had the opportunity to opt-out of the federal statute, but only a minority did so. Loonin & Renuart, *supra* note 3, at 175.

5. 15 U.S.C. § 1610(a)(1) (noting that state law is not preempted "except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency"). According to the Federal Reserve Board, a state law is "inconsistent" if "it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law." 12 C.F.R. § 226.28 (2008).

6. *See, e.g.*, Press Release, Standard & Poor's, Standard & Poor's Addresses Massachusetts Regulations Regarding High Cost Loans (Dec. 21, 2005), *available at* [http://www2.standardandpoors.com/spf/pdf/fixedincome/Massachusetts\\_Regulations\\_HighCost\\_Loans.pdf](http://www2.standardandpoors.com/spf/pdf/fixedincome/Massachusetts_Regulations_HighCost_Loans.pdf).

## Recent Developments

Since this Article was originally prepared for a symposium at Pace University Law School in March 2009, there have been significant developments that are not favorable for those who argue in support of preemption. Notable among these developments is the June 29, 2009 decision of the United States Supreme Court in *Cuomo v. Clearing House Association*. There, the Court held that the visitorial powers of the Office of the Comptroller of the Currency under the National Bank Act preempted the issuance of a subpoena by the New York State Attorney General under New York's law authorizing the investigation of "fraudulent or illegal acts," but did not preempt an action against a National Bank to enforce New York State law.<sup>7</sup> While it is sometimes suggested that the *Cuomo* decision signals the end of National Bank Act preemption,<sup>8</sup> the ruling only concerns the effect of the Federal Government's exclusive visitorial powers over National Banks. As explained more fully below, the holding does not purport to change the law of preemption as applied to state substantive laws governing National Banks. The decision may, however, signal an increasing skepticism in the Supreme Court towards preemption arguments, contrary to the prior trend.

In addition, the new leadership of the Department of the Treasury has signaled an interest in limiting federal preemption of state law (viewing federal rules as a "floor" rather than a "ceiling"), despite proposing an increase in the scope and detail of federal regulation of bank lending practices.<sup>9</sup> At present this sentiment remains only a proposal and has not resulted in the repeal of the federal regulations relied on by the courts in finding preemption. Notably, the comprehensive federal consumer financial protection program, which is proposed by the Obama administration, would defuse one of the chief policy arguments against federal preemption:

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7. *Cuomo v. Clearing House Ass'n*, 129 S. Ct. 2710, 2721-22 (2009) (citing N.Y. EXEC. LAW ANN. § 63(12) (West 2002)).

8. David A. Scheffel, *The National Bank Act: So Much For Preemption*, N.Y. L.J., Aug. 3, 2009, at 1.

9. DEPT OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 61 (2009), available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf).

the idea that preemption means the absence of regulation.<sup>10</sup> In any case, changes in the regulatory landscape affecting the scope of federal preemption of state banking law must be expected.

### I. State Subprime Lending Laws and Market Uncertainty

A recent count shows that at least twenty-five states, plus the District of Columbia, have statutes targeted at subprime lending practices.<sup>11</sup> Many of these statutes impose liability for damages and other remedies resulting from loans that violate that statute's requirements and limits, and they also bar enforcement and collection on such loans and any related mortgages.<sup>12</sup>

#### A. Market Uncertainty Due to Assignee Liability

Because the assignees of mortgages—i.e., the trustee responsible for securitized pools of mortgages—can be subjected to “indeterminate liability” under some state predatory lending laws, Standard & Poor's announced (well prior to the current crisis) that it was unable to issue ratings for certain RMBS if their loan pools contained mortgages originating with state-regulated lenders, in at least some states with subprime lending laws.<sup>13</sup> In other states, the ratings agency requires that certain contract terms be included in securitization deals that include loans from these states.<sup>14</sup> In a

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10. See, e.g., Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 145 (2009) (“For much of the consumer financial product market, the preemption experience has effectively been a deregulation experience.”).

11. See Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 364 (2005); Robert E. Litan, *Unintended Consequences: The Risks of Premature State Regulation of Predatory Lending*, AM. BANKERS ASS'N, at 20-21, available at <http://www.aba.com/NR/rdonlyres/D881716A-1C75-11D5-AB7B-00508B95258D/28871/PredReport200992.pdf>. See also Connecticut Abusive Home Loan Lending Practices Act, CONN. GEN. STAT. § 36a-746 (2008).

12. Azmy, *supra* note 11, at 373-75.

13. See, e.g., Press Release, Standard & Poor's, *supra* note 6.

14. Natalie Abrams & Maureen Coleman, *Evaluating Predatory Lending Laws: Standard & Poor's Explains its Approach*, Standard & Poor's Ratings Direct (Apr. 15, 2003), <http://www.housingchoice.org/news%20stories/0415>

2003 release, Standard & Poor's explained why this was necessary:

[M]ost importantly from Standard & Poor's perspective, a predatory lending statute's imposition of liability on purchasers or assignees of mortgage loans ("assignee liability") might reduce the availability of funds to pay investors in securities backed by mortgage loans governed by the statute. This would occur if the purchaser or assignee were found to hold a loan that violated the statute ("predatory loan"), even if the purchaser or assignee did not itself engage in predatory lending practices.<sup>15</sup>

With respect to Georgia and New York, for example, Standard & Poor's required that, to be rated, an RMBS issuer must: "i) identify high-cost loans; and ii) identify which high-cost loans are predatory and prevent their transfer into the securitization."<sup>16</sup> In addition, "because of the increased risks associated with the inclusion of high-cost loans in securitizations," Standard & Poor's required that "the representation and warranty that the loans are in compliance with all applicable laws be provided by an entity that has sufficient creditworthiness and is willing and financially able to repurchase predatory high-cost loans, as well as cover any contingent liability associated with securitizing" subprime loans.<sup>17</sup>

B. *New York Subprime Lending Law*: LaSalle Bank, N.A. v. Shearon

A quick look at the details of New York State's High Cost Home Loan statute<sup>18</sup> shows how and why state law governing subprime loans creates uncertainty. In *LaSalle Bank, N.A. v.*

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2003.htm.

15. *Id.*

16. *Id.*

17. *Id.*

18. N.Y. BANKING LAW § 6-1 (McKinney 2009).

*Shearon*,<sup>19</sup> a debtor prevailed in New York State Supreme Court in bringing an affirmative claim against a trustee holding mortgages as part of a pool. The plaintiff, a national bank, brought suit as a trustee and holder of a mortgage loan issued by a subprime lender, WMC Mortgage Corp. (“WMC”).<sup>20</sup> The decision showed that New York’s subprime statute can result in draconian consequences for the holder of a subprime loan who cannot prove that the loan was made in accordance with the statute’s requirements. In *LaSalle Bank*, the court ruled on summary judgment that the loan and mortgage were void and unenforceable, and it awarded the debtor a panoply of damages: the return of all points; fees and payments on principal and interest; direct and consequential damages in amounts to be determined at a hearing; and attorney’s fees.<sup>21</sup> These remedies were assessed against a trustee, i.e., an assignee of the loan who, under the common law, would not have been subject to defenses or liabilities against the original lender, presuming that the trustee was a holder in due course or the assignee of such a holder.<sup>22</sup>

The New York statute covers first mortgages to individuals with interest rates that “exceed eight percentage points over the yield on treasury securities having comparable periods of maturity” to the mortgage or loans with points and fees exceeding 5%, among other thresholds.<sup>23</sup> The scope of the statute is limited, by definition, to loans in amounts conforming to the size limits set by the Federal National Mortgage Association (“Fannie Mae”) for repurchase by that institution

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19. 881 N.Y.S.2d 599 (Sup. Ct. 2009) (denying motion for reconsideration); *LaSalle Bank, N.A. v. Shearon*, 850 N.Y.S.2d 871 (Sup. Ct. 2008) (granting debtor-defendant’s cross-motion for summary judgment on claim under High Cost Home Loan law). The plaintiff can be expected to appeal this decision, which appears to be the first published decision in New York under the High Cost Home Loan law.

20. *LaSalle Bank*, 881 N.Y.S.2d at 600.

21. *LaSalle Bank*, 850 N.Y.S.2d at 878-79.

22. *Id.* See also U.C.C. § 3-302(a)(2) (2005); *Midfirst Bank SSB v. C.W. Haynes & Co.*, 893 F. Supp. 1304, 1319-20 (D.S.C. 1994) (holding that Ginnie Mae, which had acquired the mortgage as part of a pool for securitization, was a holder in due course not subject to most defenses against the original lender).

23. N.Y. BANKING LAW § 6-*l*(1)(d), (1)(g)(i) (McKinney 2009) (defining “High Cost Home Loan”). The statute covers loans applied for on or after April 1, 2003. *Id.* § 6-*l*.

(presumably, at the time of origination of the loan).<sup>24</sup>

The *LaSalle Bank* court found violations of New York Banking Law § 6-1(2)(k) (“lending without due regard to repayment ability”), § 6-1(2)(l)(ii) (counseling notice requirement), and § 6-1(2)(m) (points and fees exceeding three percent of the principal).<sup>25</sup> According to the court, the loan was made “without due regard for repayment ability,” in violation of § 6-1(2)(k). Because the court found that the violations of the statute were “intentional,”<sup>26</sup> the loan and mortgage were void and unenforceable under § 6-1(10), “strip[ping] the lender from having a right to collect, receive or retain any principal, interest, or other charges whatsoever with respect to the loan, as well as giving the borrower the ability to recover any payments made under the agreement.”<sup>27</sup>

In addition, the court allowed direct and consequential damages against the plaintiff—a trustee and, presumably, a holder in due course of the mortgage note—for the conduct of the lender from whom the loan was acquired.<sup>28</sup> There is an argument, however, that the statute does not authorize such assignee liability. The statute refers only to causes of action against “lender[s]” and “mortgage broker[s].”<sup>29</sup> In a section concerning the liability of assignees seeking to enforce covered loans, the statute provides only that “a borrower may assert

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24. *Id.* § 6-1(1)(e) (defining “Home Loan”). See also Fannie Mae, Historical Conventional Loan Limits, <http://www.fanniemae.com/aboutfm/pdf/historicalloanlimits.pdf> (last visited Sept. 23, 2009); Press Release, Fed. Hous. Fin. Agency, Conforming Loan Limit for U.S. to Remain \$417,000 in 2009; Different Limits in Some Areas (Nov. 7, 2008), available at <http://www.fhfa.gov/GetFile.aspx?FileID=135>.

25. *LaSalle Bank*, 850 N.Y.S.2d at 873-78. See also Alan H. Scheiner, *Federal Preemption of State Subprime Lending Laws*, N.Y. L.J., Apr. 22, 2008, at 4, 7.

26. *LaSalle Bank*, 850 N.Y.S.2d at 875, 878.

27. *Id.* at 878-79. As a result, the debtor, who had purchased the property with “no money down,” would receive title to the property *gratis*, a plainly inequitable consequence, especially where, as in that case, the debtor had lied to obtain the loan. The borrower had claimed on his application a significantly greater income than was reported on his tax returns. Although stating that “this court will not condone fraud by the borrower,” the decision noted that the statute requires that ability to pay be “verified by detailed documentation of all sources of income and corroborated by independent verification,” apparently even where the borrower actively sought to conceal the inability to pay. *Id.* at 873, 875, 877.

28. *Id.* at 878-79.

29. N.Y. BANKING LAW § 6-1(6) (McKinney 2009).

any claims in recoupment and defenses to payment . . . that the borrower could assert against the original lender of the loan.”<sup>30</sup> While the “recoupment” of payments may be permitted, other damages against an assignee are not explicitly authorized.<sup>31</sup>

C. *The Massachusetts Decision in Fremont Investment & Loan*

Another recent development in subprime litigation under state law raises the uncertainty level even higher. In an action brought by the Attorney General of Massachusetts, the Supreme Judicial Court held that a court could enjoin foreclosure on mortgages under the unfair trade practice law of Massachusetts even though the mortgages were not governed by the terms of the Massachusetts Predatory Home Loan Practices Act.<sup>32</sup> The court upheld the trial court’s decision enjoining foreclosure (pending settlement or trial on the fairness of each specific mortgage transaction) if the mortgage contained all of the following characteristics, which the court deemed presumptively unfair: (1) “an introductory rate period of three years or less”; (2) an introductory rate three or more percentage points below the fully indexed rate; (3) a debt-to-income ratio at the fully adjusted rate of more than 50%; (4) a loan-to-value ratio of 100% (i.e., no money down), or a “substantial prepayment penalty,” or any prepayment penalty beyond the introductory three years.<sup>33</sup> Although these practices were not prohibited by the terms of any federal or state law or regulation at the time the loans were made, the court relied on warnings issued by regulators, as well as the bank’s settlement with the Federal Deposit Insurance Corporation discontinuing some of these practices, to the effect that lending regardless of the ability to repay a loan was “unsafe” and “presumptively unfair.”<sup>34</sup> The injunction affects

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30. *Id.* § 6-1(13).

31. *Id.* The statute would also allow the remedy of rescission against assignees, but that at least would have required that the transaction be unwound, presumably divesting the borrower of the property and returning the original loan proceeds to the lender or its assignee. *Id.* § 6-1(11).

32. *Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548, 560-61 (Mass. 2008).

33. *Id.* at 554.

34. *Id.* at 559.

as many as 2,490 mortgages.<sup>35</sup>

Thus, under the *Fremont* decision, even compliance with a state's predatory lending statute will not guarantee that a subprime mortgage is enforceable under state law. Accordingly, the protective measures adopted by parties to securitization—such as those required by Standard & Poor's—would be fruitless, because mortgages that were neither covered by, nor in compliance with, predatory lending legislation would nevertheless be deemed unenforceable. Indeed, an entire pool of mortgages, apparently enforceable under prior law (whatever that enforcement may be worth in today's market) could be rendered worthless upon a *post hoc* determination of unfairness.<sup>36</sup>

Although the impact of legal uncertainty and litigation risk may appear small compared to the overall economic impairment of RMBS assets, adding litigation risk to the overall systemic risk already in play is the last thing needed by struggling institutions and government agencies trying to obtain value for illiquid securities.<sup>37</sup>

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35. *Id.* at 552 n.6.

36. In addition to the Massachusetts action against Fremont, other state attorneys general have been active against mortgage lenders. For example, in 2007, Novastar Mortgage, based in Missouri, settled a class action for subprime overcharges that were allegedly deceptive under Washington state law. Kenneth C. Johnston et al., *The Subprime Morass: Past, Present, and Future*, N.C. BANKING INST. 125, 133 (2008). In December 2008, Countrywide Financial settled predatory lending claims brought by eleven states' attorneys general, resulting in an agreement to provide up to \$8.4 billion to reduce borrowers' obligations, affecting almost 400,000 mortgages. *See, e.g.*, Andrew Harris, *Countrywide Settles Fraud Cases for \$8.4 Billion*, BLOOMBERG, Oct. 6, 2008, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aWdK8sUC0Lf0&refer=home>.

37. In addition, since this Article was originally prepared, the Massachusetts Attorney General obtained a settlement from Goldman Sachs, under which that bank—a securitizer but not a lender of subprime mortgages—agreed to make \$60 million in payments to mortgage holders as well as to the State itself. William M. Bulkeley, *Goldman Settles Subprime Inquiry*, WALL ST. J., May 12, 2009, at C3. Because this was the result of a pre-litigation settlement, Massachusetts never made clear which law it was enforcing when it obtained these payments. *Id.*

## II. The Federal Reserve Board Regulates Subprime Lending Under TILA

On July 30, 2008, the Federal Reserve Board issued the final version of its amendments to Regulation Z, under TILA as amended by the Home Ownership and Equity Protection Act (“HOEPA”), intended to regulate subprime mortgage lending and provide remedies to borrowers somewhat similar to those provided by state subprime laws.<sup>38</sup> The new regulations became effective October 1, 2009 and govern all lenders, whether state- or federally-chartered, and all mortgage loans, whether primary or secondary, except Home Equity Lines of Credit.<sup>39</sup>

Among other things (such as advertising and disclosure rules), the regulations create national standards for the underwriting of mortgage loans and prohibit the extension of credit based solely on the value of collateral without regard to repayment ability.<sup>40</sup> The regulations require verification of income by third-party documentation, such as tax reporting documents, “that provide reasonably reliable evidence of the consumer’s income or assets,” and verification of current obligations.<sup>41</sup> The regulation establishes additional prohibitions for “higher-priced mortgage loans,” which are defined by relatively modest thresholds: 1.5% above prime for a first mortgage and 3.5% above prime for a second mortgage.<sup>42</sup> For higher-priced mortgage loans, the rule prohibits: (i) issuance without regard to repayment ability (as with all mortgage loans); (ii) prepayment penalties, except where those penalties apply for no more than two years, are waived for

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38. Truth in Lending; Part III, 73 Fed. Reg. 44,522 (July 30, 2008) (amending Truth in Lending (Regulation Z), 12 C.F.R. pt. 226 (2009)).

39. *Id.* at 44,522; 44,531. The regulations are promulgated pursuant to 15 U.S.C. § 1639 (2006), a provision of HOEPA which grants broad authority to the Federal Reserve Board to regulate unfair or deceptive practices “in connection with . . . mortgage loans.” *See also* 15 U.S.C. § 1602(f) (defining “creditor” subject to TILA to include all lenders). Some small lenders with very limited activity are exempted from Regulation Z. Truth in Lending (Regulation Z), 12 C.F.R. § 226.2(a)(17)(i) (2008).

40. 73 Fed. Reg. at 44,522.

41. *Id.* at 44,603; 12 C.F.R. § 226.34(ii)(A).

42. 73 Fed. Reg. at 44,603. *See also* 12 C.F.R. § 226.35(a). Construction loans, bridge loans, reverse-mortgages, and home equity lines of credit are not covered. *Id.*

refinance by the creditor or an affiliate, and the amount of interest is frozen for at least four years; (iii) “failure to escrow property taxes and insurance;” and (iv) structuring home equity lines of credit to evade the requirement of the regulation.<sup>43</sup>

The remedies available to consumers under the new Regulation Z are provided by TILA. Consumers may bring actions against a creditor (meaning an original lender) for actual damages, as well as various items of special statutory damages, plus court costs and attorney’s fees.<sup>44</sup> Claims against the assignees of creditors—which are especially important in the era of securitization—are more limited. In the case of a securitized loan, the original creditor may be defunct or undercapitalized and essentially judgment proof. In addition, the main benefit to a debtor from predatory lending laws would arise as a counterclaim or defense in a foreclosure proceeding against the assignee, where, in the case of a securitized loan, the original lender would typically not be a party.

With respect to HOEPA loans, a narrow class of very high-cost second mortgages, assignees are subject to the same remedies available against the original creditor unless they can demonstrate that they could not have discovered the violation using reasonable due diligence.<sup>45</sup> With respect to other mortgages, assignees can be held liable only for violations that are apparent on the face of the consumer’s TILA-required disclosure statement.<sup>46</sup> The statute also creates a limited right of rescission as to any loan in violation of “this section,” meaning 15 U.S.C. § 1639, the section authorizing Regulation Z.<sup>47</sup> Thus, mortgages may arguably be rescinded where they violate Regulation Z.

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43. 73 Fed. Reg. at 44,603. *See also* 12 C.F.R. § 226.35(b). Additional rules are promulgated with respect to mortgage brokers, appraisers and servicers. 73 Fed. Reg. at 44,604; 12 C.F.R. § 226.36. The regulation applies the same rules to loans already governed by HOEPA, which governs only high-cost second mortgages. 15 U.S.C. § 1602(aa); 12 C.F.R. § 226.32(a). This is not intended to be a complete description of the amendments to Regulation Z, which are complex and are explained in detail in ninety-two pages of the Federal Register. 73 Fed. Reg. at 44,522-44,614.

44. Truth in Lending; Part II, 73 Fed. Reg. 1672, 1716 (proposed July 9, 2008); 15 U.S.C. § 1640(a).

45. Truth in Lending; Part II, 73 Fed. Reg. at 1716; 15 U.S.C. § 1641(d).

46. 15 U.S.C. § 1641(a).

47. *Id.* § 1639(j). *See also id.* §§ 1635(a), 1641(a).

The amendments to Regulation Z contain no new preemption provisions and would be governed by the same limited “conflict” preemption rules as TILA in general.<sup>48</sup> However, TILA provisions regarding assignee liability are less generous to borrowers than many state subprime lending laws.<sup>49</sup> This Article proposes that the expansive damages provisions of state laws as applied to assignees, targeting the same loan practices as Regulation Z, interfere with the federal scheme and are therefore preempted.

### III. Federal Preemption of State Subprime Lending Laws

The “dual banking system”<sup>50</sup> of the United States has generated an elaborate law of preemption, meant to resolve conflicts between overlapping state and federal jurisdiction. Generally speaking, federal law recognizes three species of banking law preemption. The first, express preemption, arises when Congress states its intent to preempt state law in a statute.<sup>51</sup> The second, field preemption, is

preemption [that] may be inferred when federal regulation in a particular field is so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it. In such cases of field preemption, the mere volume and complexity of federal regulations demonstrate an implicit congressional intent to displace all state law.<sup>52</sup>

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48. See Truth in Lending; Part III, 73 Fed. Reg. 44,522 (July 30, 2008) (amending Truth in Lending (Regulation Z), 12 C.F.R. § 226 (2009)).

49. Amzy, *supra* note 11, at 374-76; David J. Weiner, Comment, *Assignee Liability in State Predatory Lending Laws: How Uncapped Punitive Damages Threaten the Secondary Mortgage Market*, 55 EMORY L.J. 535, 555 & n.178 (2006).

50. COMPTROLLER OF THE CURRENCY ADM’R OF NAT’L BANKS, NATIONAL BANKS AND THE DUAL BANKING SYSTEM 1 (2003), available at <http://www.occ.treas.gov/ftp/release/2003-83a.pdf> (“The ‘dual banking system’ refers to the parallel state and federal banking systems that co-exist in the United States.”).

51. See, e.g., *Silvas v. E\*Trade Mortgage Corp.*, 514 F.3d 1001, 1004 (9th Cir. 2008) (citing *Bank of Am. v. City & County of San Francisco*, 309 F.3d 551, 558 (9th Cir. 2002)).

52. *Id.*

The third, conflict preemption, occurs “when state law actually conflicts with federal law. Such a conflict arises when compliance with both federal and state regulations is a physical impossibility, or when state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress . . . .”<sup>53</sup>

All of these species of preemption may be deployed in arguments for the preemption of state subprime lending laws. Federally chartered lenders enjoy something close to field preemption and, therefore, are the most clearly protected against state predatory lending laws.<sup>54</sup> For state-chartered lenders, however, preemption may depend on the specific subject-matter of the state law or the transaction at issue. Interest rate limits and ARM transactions regulations, for example, are subject to express preemption in particular statutes.<sup>55</sup> Other state regulations—most importantly disclosure rules overlapping with the Truth in Lending Act—are subject only to conflict preemption.<sup>56</sup> Thus, it is a peculiar characteristic of our “dual” banking system that whether a particular mortgage is enforceable—or even a source of liability for its owner—depends (among other things) on whether its originator or owner is a federally chartered bank or a state-organized lender.

#### A. *Preemption for Federally Chartered Institutions*

Federal preemption of state law as applied to federally chartered institutions—such as a National Bank, Federal Savings Bank, or Federal Savings and Loan—is of constitutional and statutory origin. The long tradition of federal supremacy in banking traces back to the 1819 decision

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53. *Id.* See also *Wachovia Bank v. Burke*, 414 F.3d 305, 313 (2d Cir. 2005) (addressing preemption in National Bank Act); Catherine M. Brennan & Meghan S. Musselman, *Consumer Credit: Preemptions and Regulations*, 41 MD. BAR J. 18, 20 (Nov./Dec. 2008) (describing three varieties of preemption).

54. See *Silvas*, 514 F.3d at 1005 (finding field preemption under Home Owners Loan Act of 1933 (“HOLA”); 12 C.F.R. §§ 560.2(b)(5), (9) (2008)). *But see Wachovia*, 414 F.3d at 313-14 (describing issue as “conflict preemption” under National Bank Act).

55. See *supra* notes 3 & 4 and accompanying text.

56. See *supra* note 5 and accompanying text.

*McCulloch v. Maryland*, where the Supreme Court ruled, relying on the Supremacy Clause, that Maryland could not tax a federal bank.<sup>57</sup> The Supreme Court recently reiterated the rule of preemption in *Watters v. Wachovia Bank*,<sup>58</sup> asserting that “state law may not significantly burden a national bank’s own exercise of its real estate lending power, just as it may not curtail or hinder a national bank’s efficient exercise of any other power, incidental or enumerated under the [National Bank Act].”<sup>59</sup>

The Office of the Comptroller of the Currency (the “OCC”), in the Department of the Treasury, “is the federal agency entrusted with the ‘primary responsibility for surveillance of the business of banking authorized by’” the National Bank Act.<sup>60</sup> In 2004, the OCC adopted a rule recognizing that state laws aimed at predatory lending were necessarily preempted, in the case of nationally chartered banks, by 12 U.S.C. § 371.<sup>61</sup> The regulation states:

Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks. Specifically, a national bank may make real estate loans under 12 U.S.C. [§] 371 and § 34.3, without regard to state law limitations concerning:

.....

(3) Loan-to-value ratios;

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57. 17 U.S. 316, 436.

58. 550 U.S. 1 (2007) (affirming that mortgage lending is a power explicitly granted to national banks by the National Bank Act, 12 U.S.C. § 24 (Seventh) (2006)).

59. *Id.* at 13 (extending § 371 preemption to national bank subsidiaries). In addition, any limits on mortgage points and fees set by state law may be preempted by the federal Depository Institutions Deregulation and Monetary Control Act of 1980 (“DIDMCA”). *See, e.g.*, 12 U.S.C. § 1735f-7a(a)(1) (2006); *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 10-11 (2003) (preemption of state law usury claims); *Wolfert v. Transamerica Home First, Inc.*, 439 F.3d 165, 175 (2d Cir. 2006) (reverse mortgage not invalidated by state usury law).

60. *Wachovia Bank v. Burke*, 414 F.3d 305, 312 (2d Cir. 2005) (quoting *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256 (1995)).

61. 12 C.F.R. § 34.4 (2008).

(4) The terms of credit, including schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;

....

(9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;

(10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;

....

(12) Rates of interest on loans . . . .<sup>62</sup>

In short, the regulation holds that a typical state subprime lending law cannot be enforced against national banks. Although only incidentally addressed by the Supreme Court's decision in *Watters*,<sup>63</sup> that case leaves little doubt that the regulation is valid. Numerous courts of appeals have held that state laws or regulations similar to subprime lending laws—such as those prohibiting certain practices in consumer lending—are inapplicable to national banks on the basis of the OCC regulation (or a similar Office of Thrift Supervision (“OTS”) regulator) and Supreme Court precedent.<sup>64</sup> Thus, it

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62. *Id.* (footnote omitted).

63. 550 U.S. at 13 (citing 12 C.F.R. § 34.4(a)(1) (2006)).

64. *See, e.g.*, *Silvas v. E\*Trade Mortgage Corp.*, 514 F.3d 1001, 1006-07 (9th Cir. 2008) (holding that claims against federal savings banks under California's Unfair Competition Law and state law claim damages for violations of TILA are preempted by the Home Owners Loan Act of 1933 and 12 C.F.R. §§ 560.2(b)(5), (9) (2008)); *Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1037-38 (9th Cir. 2008) (noting that provisions of California's Civil Code—which require certain disclosures in credit card “convenience checks”—are preempted by the National Bank Act, which empowers national banks to “loan money on personal security”); *Pac. Capital Bank, N.A. v.*

should be clear that mortgage loans made by federally chartered institutions are not subject to state predatory lending statutes, which explicitly target the very conduct that is at the heart of the bank's lending powers.<sup>65</sup>

The OCC regulation does, however, contain a savings clause for the background law of "general application"<sup>66</sup> of the states, consistent with the general law of preemption. The OCC states:

State laws on the following subjects are not inconsistent with the real estate lending powers of national banks and apply to national banks to the extent that they only incidentally affect the exercise of national banks' real estate lending powers:

- (1) Contracts;
- (2) Torts;
- (3) Criminal law;

....

- (9) Any other law the effect of which the OCC determines to be incidental to the real estate lending operations of national banks or otherwise consistent with the powers and purposes set out in § 34.3(a).<sup>67</sup>

Because of the exemption for laws of general application, recent federal court decisions reveal a muddled picture on the question of whether federally chartered lenders are exempt

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Connecticut, 542 F.3d 341, 352 (2d Cir. 2008) (holding state law regulating tax refund loans is preempted as applied to national banks and their agents); *Wachovia Bank*, 414 F.3d at 312, 321 (holding that federal law preempts state regulation of operating subsidiaries of national banks, including all bank examinations and inspections).

65. See Levitin, *supra* note 10, at 163-172 and accompanying footnotes (reviewing law on preemption of direct state regulation of federally chartered institutions and finding that "there appears to be little residual state authority to regulate national banks directly").

66. *Watters*, 550 U.S. at 11. See also *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996) (holding that states may regulate national banks where doing so "does not prevent or significantly interfere with the national bank's exercise of its powers").

67. 12 C.F.R. § 34.4(b) (2008) (footnote omitted).

from state unfair trade practices claims. For example, in a multi-district class action against a mortgage servicing company under various states' unfair trade practices statutes, the United States Court of Appeals for the Seventh Circuit held that, regardless of the statute invoked, preemption depends upon whether the claim is the equivalent of a common law fraud or breach of contract claim.<sup>68</sup> The claim would only be preempted if it could not have been brought under the common law.<sup>69</sup> The United States Court of Appeals for the Ninth Circuit applied a similar substantive analysis, asking whether the state law, as sought to be applied, would "significantly interfere" with any of the powers granted by federal law.<sup>70</sup> The court held that claims based on lending disclosures were preempted even if brought under general unfair trade statutes.<sup>71</sup> Similarly, the United States District Court for the Southern District of New York held that claims under New York's general consumer fraud statute were not preempted as applied to a federal savings association, although the OTS "occupies the entire field of lending regulation for federal savings associations," because the claims did not purport to "set substantive standards or establish particular requirements for lending operations in the state of New York."<sup>72</sup>

Some lower courts have applied a more formalistic approach, resulting in different outcomes. For example, the United States District Court for the Southern District of West Virginia ruled, in a series of decisions in 2008 and 2009, that common law claims of unconscionability can be asserted against federally chartered banks, even if they are directed at "predatory lending practices," "home equity skimming," or "bogus appraisals," which are all subjects that the OCC has

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68. *In re Ocwen Servicing, LLC*, 491 F.3d 638 (7th Cir. 2007).

69. *Id.* at 642-43, 647-48 (finding that in many instances it was not possible to determine from the complaint whether the claim was preempted).

70. *Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1037 (9th Cir. 2008).

71. *Id.* at 1037-38. *See also* *Jefferson v. Chase Home Fin.*, No. 06-6510, 2008 WL 1883484, at \*12-14 (N.D. Cal. Apr. 29, 2008) (finding that state laws prohibiting misrepresentation in general are not preempted under HOLA, while laws aimed specifically at banking or purporting to dictate substantive banking practices are preempted).

72. *Binetti v. Wash. Mut. Bank*, 446 F. Supp. 2d 217, 219-20 (S.D.N.Y. 2006) (applying OTS preemption regulation 12 C.F.R. § 560.2 (2008)).

made clear are preempted.<sup>73</sup> A 2008 decision in the United States District Court for the Southern District of New York held that claims against mortgage lenders based on state unfair or deceptive practices statutes were not preempted because the statutes themselves did not specifically target banking practices.<sup>74</sup> However, because subprime lending laws explicitly target banks and lending practices, they cannot arguably be “laws of general application” and therefore would not fall within even the most generous application of the “background law” exception to preemption.<sup>75</sup>

The recent Supreme Court decision in *Cuomo v. Clearing House Ass’n* does not purport to change this law. That decision discussed whether the exclusive “visitorial powers” provision of the National Bank Act, and OCC regulations interpreting the preemptive scope of the OCC’s exclusive visitorial powers, prevented the New York State Attorney General from requesting documents from national banks. Citing a distinction between regulation and enforcement, the Supreme Court held that although a subpoena would be preempted by the OCC’s exclusive visitorial powers, a lawsuit to enforce an otherwise valid and non-preempted state law would not.<sup>76</sup> The Court observed that many state laws were not preempted as applied to national banks, including some that were banking-directed, but the Court did not hold that any particular state law was not preempted, nor did it address the general rules governing the preemption of state law burdening federal banking powers. In fact, the only state statute specifically mentioned in the decision is the one that the court held *was* preempted: New York’s Executive Law permitting the Attorney General to issue subpoenas to investigate fraud.<sup>77</sup> Thus, the decision presumes that, in a hypothetical future lawsuit, the state laws that would be enforced by the Attorney General are

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73. *Conrad v. Wells Fargo Bank, N.A.*, No. 08-0829, 2009 WL 36478, at \*2-3 (S.D. W. Va. Jan. 5, 2009) (concluding that claims based on ARMs are preempted by 12 C.F.R. § 34.21(a) (2008), but that claims of unconscionable banking practices are not preempted).

74. *Baldanzi v. WFC Holdings Corp.*, No. 07-9551, 2008 WL 4924987, at \*2 (S.D.N.Y. Nov. 14, 2008).

75. See *supra* notes 61-62 and accompanying text.

76. *Cuomo v. Clearing House Ass’n*, 129 S. Ct. 2710, 2721-22 (2009).

77. *Id.*

not preempted.<sup>78</sup> Accordingly, although *Cuomo* strikes down one OCC regulation on preemption (concerning visitorial powers), it does not undercut 12 C.F.R. § 34.4 or the doctrine articulated in *Watters* or other prior cases.<sup>79</sup>

If a national bank or federal savings association initiates a mortgage loan, it is clear under *Watters*, OTS and OCC regulations, and other precedent, that the terms of such a mortgage are not governed by state predatory lending laws (although, as noted above, they may be governed by more general trade and consumer practices statutes). The Supreme Court has stated that “[s]ecurity against significant interference by state regulators is a characteristic condition of the ‘business of banking’ conducted by national banks, and mortgage lending is one aspect of that business.”<sup>80</sup>

However, preemption is only of limited help to federally chartered banks unless it protects them where they are the assignee of a mortgage as well as the originator, or where they are the beneficial holder of the mortgage through RMBS or an RMBS derivative. There are arguments—as yet untested—for why they should be so protected. First, *Watters*-style preemption goes further than the power to make loans. For example, federal law empowers national banks not only to make mortgage loans, but also to “purchase or sell” such loans.<sup>81</sup> When a national bank acquires a mortgage or an RMBS or its derivative, it is exercising that power to “purchase” real estate loans. To impose liability on the national bank for that exercise of its banking power runs afoul of *Watters* and 12 U.S.C. § 371. As *McCulloch v. Maryland* shows, the protection of federally created banks from state-created, potentially destructive burdens is precisely the

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78. The only decision to date considering the National Bank Act’s preemption of substantive state law in light of *Cuomo* appeared to find no change in the law and applied the preexisting standard that national banks were protected from “unduly burdensome and duplicative” state laws that “significantly interfere with” the exercise of their federal powers. *Davis v. Chase Bank U.S.A., N.A.*, No. 06-04804, 2009 WL 2868817, at \*5 (C.D. Cal. Sept. 3, 2009).

79. Only time will tell whether the decision signals a new hostility of the Court toward preemption arguments in general.

80. *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 18 (2007).

81. 12 U.S.C. § 371(a) (2006).

purpose of preemption.<sup>82</sup>

As noted above, federal law recognizes only very limited assignee liability for violations of Regulation Z that are akin to conduct prohibited by state law predatory lending statutes. A state power to impose upon a national bank *unlimited assignee liability*, arising from mortgages that are valid under federal and “background” state law, as well as deprive those mortgages of all value, clearly approaches the “power to destroy” of which *McCulloch* warned.<sup>83</sup> “Accordingly, as part of their ‘business of banking,’ national banks should be able to purchase mortgage loans free of state banking law restrictions that would otherwise apply.”<sup>84</sup>

There is a contrary argument that a loan governed by state law should be deemed taken subject to *all* state laws applicable to that loan at the time of acquisition, in which the loan is acquired from a state chartered lender and, therefore, is presumptively governed by state, not federal, law at the time of acquisition.<sup>85</sup> However, imposing vicarious liability for damages on a national bank by operation of state banking law, solely because of the purchase or assignment of a loan to the national bank acting as trustee (as occurred in *LaSalle Bank*), is another matter entirely.

Imposing assignee liability on national banks would “significantly interfere” with and “significantly impair” the national banks’ exercise of their authority to purchase real estate loans.<sup>86</sup> It is manifest, now more than ever, that “[n]ational banks are not merely private moneyed institutions, but agencies of the United States created under its laws to promote its fiscal policies.”<sup>87</sup> Allowing damages actions against

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82. 7 U.S. 316, 391 (1819).

83. *Id.*

84. Scheiner, *supra* note 25, at 7.

85. *Cf.* Fed. Nat’l Mortgage Ass’n v. Lefkowitz, 390 F. Supp. 1364, 1370 (S.D.N.Y. 1975) (explaining that FNMA acquires mortgages “accompanied by the appurtenances of state law” and that such laws are not preempted solely because FNMA purchases the mortgage).

86. *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007).

87. *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305, 322 (2d Cir. 2005) (quoting *First Nat’l Bank of Hartford, Wis. v. City of Hartford*, 273 U.S. 548, 550 (1927)). Indeed, some national bank holding companies are now substantially owned by the U.S. Government. Potential preemption by virtue of federal ownership, however, raises distinct legal issues.

federally-chartered institutions because they acquired distressed mortgages, either directly or through RMBS or their derivatives, can only add the proverbial insult to injury, and exacerbate the financial crisis.<sup>88</sup> Allowing states to render valueless entire pools of previously valid mortgages—as might occur in the *Fremont* case, for example—could work nearly as much havoc on the system as unlimited damages liability to assignees. Viewed in that light, there is a strong argument that if a state statute allows assignee liability where it would be precluded under federal law, or would invalidate a loan that would be valid under federal or background state law,<sup>89</sup> the statute should be preempted as applied to national banks.

### B. *Preemption Arguments Under Regulation Z*

Regulation Z provides a basis for a preemption argument against state subprime lending laws that was previously unavailable. As noted above, however, TILA preempts only “inconsistent” state laws.<sup>90</sup> Although the new Regulation Z promulgates disclosure requirements, it also contains numerous substantive limits on the terms that may be included in mortgages. The Federal Reserve Board regulations interpreting TILA preemption, while specifically addressing matters such as disclosure requirements, do not address the preemptive effect of substantive regulatory limits on the permissible terms of mortgages (presumably because those regulations are new).<sup>91</sup> Thus, there is room to argue that

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88. In addition, on March 4, 2009, the Obama administration announced a plan to pay mortgage holders and servicers to modify mortgages in favor of borrowers. Michael Phillips & Ruth Simon, *Mortgage Bailout to Aid 1 in 9 U.S. Homeowners*, WALL ST. J., Mar. 5, 2009, at A1. These plans contribute to the Federal Government’s increasing regulation of the details of mortgage lending, weakening arguments that this is an area reserved for concurrent state control. While legal analysis must await final rule-making or legislation, any state laws interfering with the government’s plans to restructure individual mortgages—including liabilities imposed on mortgage holders or servicers that might impair their willingness to participate in such a program—would face strong preemption arguments.

89. *Cf.* *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 10 (2003) (citing *Farmers’ & Mechanics’ Nat’l Bank v. Dearing*, 91 U.S. 29 (1875)) (noting that state usury laws invalidating debts owed to national banks are preempted).

90. 15 U.S.C. § 1610(b) (2006).

91. 12 C.F.R. § 226.28(a) (2008).

because Regulation Z creates detailed and extensive rules regarding the permissible terms of mortgages, especially higher-rate mortgages, state laws that create more restrictive rules “stand[ ] as an obstacle to the accomplishment and execution of the full purposes and objective[s]” of the federal law and “would frustrate the purposes of the federal scheme.”<sup>92</sup> This is especially so with regard to aggressive state law remedies, which would subject assignees to much greater liability risk than does TILA. “An integral part of any regulatory scheme is the remedy available against those who violate the regulations.”<sup>93</sup> State law remedies against assignees going beyond those permitted by federal law would upset the delicate policy balance between enforcement benefits and the costs of liability risks that presumably determine the contours of the federal rule.<sup>94</sup> Thus, there is a strong argument that those state law remedies and the more restrictive substantive law that they enforce “stand[ ] as an obstacle to the accomplishment and execution of the full purposes and objectives” of federal policy and are therefore preempted.<sup>95</sup>

A complete rendition of the argument for implied preemption, utilizing the legislative history of TILA and Regulation Z, is beyond the scope of this Article. However, the potential exists to argue that TILA and Regulation Z created comprehensive standards for high-interest mortgage practices and related liability, which, since the recent amendment to Regulation Z, preempt all state law purporting to impose either more or less restrictive standards and liabilities.

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92. *Pac. Capital Bank, N.A. v. Connecticut*, 542 F.3d 341, 351 (2d Cir. 2008) (quoting *United States v. Locke*, 529 U.S. 89, 109 (2000); *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982)).

93. *Silvas v. E\*Trade Mortgage Corp.*, 514 F.3d 1001, 1007 n.3 (9th Cir. 2008) (citing *San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236 (1959)) (holding that longer state statute of limitations was preempted by shorter federal statute for the same violations).

94. Rescission rights, however, may be expressly reserved, depending upon how they arise under state law. TILA contains a savings clause regarding rights of rescission in foreclosure, stating that “[n]othing in this subsection [15 U.S.C. § 1635(i), regarding rescission rights in foreclosure] affects a consumer’s right of rescission in recoupment under State law.” 15 U.S.C. § 1635(i)(3). Thus, to the extent that state law provides a “right of rescission in recoupment,” it is not preempted under Regulation Z. *Id.*

95. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

C. *The Impact of Wyeth v. Levine*

The United States Supreme Court recently addressed implied preemption in *Wyeth v. Levine*, decided on March 4, 2009, holding that approvals of drug warnings by the Food and Drug Administration under the Food, Drug and Cosmetic Act (“FDCA”) did not preempt product liability lawsuits brought under state tort law.<sup>96</sup> Although preemption was rejected in that instance, the *Wyeth* decision is distinguishable from the arguments proposed above for banking preemption in important ways.

First, the FDCA contains an express and very broad savings clause that is more expansive than TILA and that is entirely absent from the National Bank Act and other federal banking enabling statutes.<sup>97</sup> The FDCA provides that state law is preempted only upon a “direct and positive conflict” with the federal statute.<sup>98</sup> In contrast, the National Bank Act and other statutes creating federally chartered banks contain no savings clauses and are interpreted to preempt any state law that “significantly impair[s]” or “significantly interfere[s]” with an authority or power granted by federal law.<sup>99</sup> TILA, the source of Regulation Z, preempts state law to the extent that it is “inconsistent” with federal law,<sup>100</sup> a far less restrictive standard than the FDCA’s “direct and positive conflict.”<sup>101</sup> The Supreme

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96. 129 S. Ct. 1187, 1191 (2009).

97. Compare Pub. L. No. 101-535, § 6(c)(1) (21 U.S.C. § 343-1 note) (2006) with National Bank Act, 12 U.S.C. § 24 (Seventh).

98. *Wyeth*, 129 S. Ct. at 1195-96 (citing 76 Stat. 793 (amending FDCA)). See also Drug Abuse Control Amendments of 1965, Pub. L. No. 89-74, § 10 (Application of State Law); Drug Amendments of 1962, Pub. L. No. 87-781, § 202 (Effect on State laws).

99. *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007).

100. 15 U.S.C. § 1610(a)(1).

101. As the Supreme Court observed in *Wyeth*, Congress had enacted express preemption for one class of products covered by the FDCA—medical devices—but had declined to do so for pharmaceuticals, supporting an inference against intent to preempt state tort law regarding pharmaceuticals. *Wyeth*, 129 S. Ct. at 1196. This same argument might be deployed against implied preemption under TILA, where certain matters, such as interest rates and ARMs, are explicitly preempted (with opt-out rights), while others are governed only by conflict preemption. See *Truth in Lending (Regulation Z)*, 12 C.F.R. pt. 226 (2009)). However, the proponent of preemption under TILA would not be arguing for implied blanket preemption of state law, but rather that in the particular case the state law as applied is “inconsistent”

Court has interpreted a general savings clause to incorporate the Court's general conflict preemption jurisprudence, which recognizes implied preemption in the case of "frustration-of-purpose."<sup>102</sup> The same argument can be made against state subprime lending laws that embody greater restrictions or liability for lenders, or more generous terms for borrowers, than federal law. The courts should recognize that federal law embodies a policy that, *up to a point*, encourages subprime lending and the enforceability of mortgages, and the states must respect the balance struck by federal authorities between lender and borrower interests.

Second, as the Supreme Court observed in *Wyeth*, the FDCA contains *no provisions* regarding a remedy for persons harmed by violations of the regulations.<sup>103</sup> But in the case of TILA, as detailed above, remedies are provided, which, through the recent amendments to Regulation Z, address precisely the same harms from predatory mortgage lending that state law attempts to reach.<sup>104</sup> The existence of these remedies weighs against applying the result in *Wyeth* to the banking context.

### Conclusion

Legal reform in response to the credit crisis should not impose greater uncertainty and liability on markets already stressed beyond the breaking point. If, as it appears, government policy is to support the revival of the securitized mortgage market, it is important that the market be presented with uniform standards regarding mortgage practices and the liability of ultimate mortgage holders. Federal law in the form of Regulation Z and TILA now provides the opportunity for such standards. Courts should utilize the various doctrines of banking preemption to apply uniform standards to federally

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with the goals and objectives of the detailed federal scheme.

102. *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 869, 874 (2000) (citing *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982)) (holding that a savings clause for common law tort actions incorporates the same implied "frustration-of-purpose" standard that would preempt state rules that "actually conflict" with federal standards).

103. *Wyeth*, 129 S. Ct. at 1199 (noting that in not enacting remedies, "[e]vidently, [Congress] determined that widely available state rights of action provided appropriate relief for injured consumers").

104. 15 U.S.C. § 1640(a).

chartered institutions originating and holding mortgages, RMBS, and their derivatives, and, perhaps, to all mortgage lenders and assignees pursuant to Regulation Z.