

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

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## **ABSTRACT**

Residential Mortgage Backed Securities (“RMBS”) and other structured finance products, such as Collateralized Debt Obligations 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. As mortgage default rates reach record highs, legal reform efforts will no doubt focus on attempts to restrict predatory lending and reform and revive the securitization system. Numerous states have enacted subprime lending laws specifically aimed at alleged predatory lending practices among high-interest and adjustable-rate mortgage lenders, often with draconian liability for even innocent assignees, such as the trustees on securitized loan pools, of mortgages that violate statutory standards. The federal government has now entered the field with amendments to Regulation Z, under the Truth in Lending Act (“TILA”), creating national standards for mortgage lending carrying much more limited assignee liability for entities, such as trustees, who acquire mortgages from originating lenders or intermediaries.

This article argues that National Banking Associations, Federal Savings Associations and other federally chartered financial institutions benefit from preemption of state subprime lending laws as applied to mortgages that they acquire, as well as those that they originate, under 12 U.S.C. § 371. The Supreme Court’s decision in *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559 (2007), reinforces a long line of authority before and since finding broad preemption with respect to federally chartered banks. Section 371 of the National Bank Act creates broad powers to “acquire” mortgage loans; a power which national banks are entitled to

exercise free of state laws that would significantly “impair” or “interfere” with such acquisitions. *See Watters*, 127 S. Ct. at 1567.

In addition, this article also outlines an argument, based on the new amendments to Regulation Z, that even state-chartered institutions may benefit from preemption under Regulation Z with respect to acquired mortgages. The TILA remedy provisions by which Regulation Z is enforced are part-and-parcel of that regulatory scheme, which now extends to quite detailed restrictions on predatory mortgage lending. Although TILA preempts only “inconsistent” state law, state subprime lending laws are inconsistent in the sense that they frustrate the “purposes and objectives” of federal policy. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *accord Geier v. American Honda Motor Co.*, 529 U.S. 861, 869 (2000). The Supreme Court’s recent decision against preemption with respect to pharmaceuticals, in *Wyeth v. Levine* (March 4, 2009), is distinguishable from the case of banking regulation.

One goal of federal policy is to revive a credit system currently *in extremis*, in part because of the risk of loss and liability associated with mortgages and mortgage-backed securities. State statutes specifically burdening institutions acquiring mortgages with assignee liability, beyond that allowed by TILA or background state law of general application, frustrate the purposes of federal policy. Recovery depends, in part, on private parties being willing to acquire and hold interests in existing mortgages, both directly and through mortgage-backed securities. Imposing unlimited liability upon mortgage assignees can only exacerbate the current crisis, by generating further uncertainty costs for mortgage assignees, leading to further market collapse or perhaps direct nationalization of mortgage-backed assets.

Therefore, both federal and state-chartered institutions acquiring mortgages or mortgage-backed securities are entitled to protection from state laws specifically aimed at mortgage lending, which they can show interfere with the purposes and objectives of federal law.