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STATE SUIT ON FEDERAL BANKING RULES IMPERILS CONSUMERS' ACCESS TO LOANS

by
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Currently a titanic battle is being waged that may well affect the availability and cost of consumer credit throughout the United States. While the outcome is relatively certain under conventional legal theory, it may well turn on a pedagogic campaign being waged by strident states attorneys general, headed by the outspoken New York Attorney General, Eliot Spitzer. The battle itself involves numerous components: states rights versus federal preemption; state consumer protections versus uniform federal consumer rules; state banking regulators versus national banking authorities; and consumer advocates versus consumer lenders. The battlefield stretches from the courts, to Congress, to state legislatures, to city councils, and, most notably, to the court of public opinion. Each day a new skirmish is reported. The implications for the consumer lending community are unprecedented.

This battle started simply enough. Consumer advocates seized upon anecdotal evidence of abuses involving mortgage lending and characterized various ill-defined practices as "predatory lending." As an aside, it should be observed that banks were rarely accused of such tactics and, when they were involved, the appropriate banking authorities took swift action to assert breaches of existing laws and to use their broad powers to intervene for safety and soundness concerns. Nonetheless, in light of the emotional rubric that dominated the predatory lending debate, state legislatures, and, in some cases cities and counties, commenced passing ad hoc protection laws applicable to their geographic jurisdictions. The scope of these laws was broad and, because of the lack of clarity as to what really constitutes "predatory" loans, the laws swept up many conventional lending practices into the "predatory" category, including legitimate sub-prime lending. In essence these laws became an impenetrable patchwork of conflicting requirements governing consumer mortgage lending. National banks, seeking to insulate themselves and their customers from the implications of these poorly drafted laws, turned to their primary regulator, the Office of the Comptroller of the Currency (OCC), for relief.

The next step was neither unprecedented nor, in terms of legal analysis, controversial. The Comptroller preempted the predatory lending law of the State of Georgia. But, it was the next action of the Comptroller that created a maelstrom: realizing that the Georgia statute, like a computer virus, was being replicated throughout the country, the OCC proposed a revision to its regulations establishing standards for which state laws would, in the future, be preempted. The breadth of the proposed rule generated immediate outrage from consumer advocates who in turn allied themselves with states attorneys general. The comment period for the proposed rule produced a vigorous campaign that, unlike most bank regulations, became the

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focus of politicians and the media. In the end, the Comptroller issued the rule with little change as final on January 7, 2004.

The nature of the rule is quite direct. The final rule amends 12 CFR parts 7 and 34 with regard to lending and deposit taking. In the final rule, the OCC has emphatically stated that state and local laws are not permitted to obstruct, impair, or condition a national bank's powers inherent under the National Bank Act. This means that any state law which impacts licensing, terms of credit, permissible rates of interest, escrows, disclosure requirements or advertising are preempted. Additionally, as to deposit taking, laws related to checking accounts, funds availability, disclosures, and abandoned or dormant accounts are also preempted. The final rule acknowledges that state laws pertaining to contracts, debt collection, property acquisition and transfer, taxation, zoning, criminal law and torts are not affected and remain enforceable against national banks. And, with that declaration, the OCC, correctly citing voluminous U.S. Supreme Court and lower court cases granting great deference to the OCC's ability to define the power of and to regulate national banks, drew the proverbial line in the sand.

Enter Attorney General Spitzer. The day that the OCC final rule was issued, Mr. Spitzer proclaimed "The OCC today issued two regulations designed to protect national banks at the expense of consumers." Within nine days of the OCC's final rule, he filed a suit alleging that a national bank's mortgage subsidiary had improperly calculated payments under a mortgage loan and was threatening to foreclose a loan that was, had payments been correctly applied, fully repaid (and, in fact, overpaid). In his suit, Mr. Spitzer seeks to impose New York laws on the national bank mortgage lender subsidiary and has proclaimed that the case "demonstrates perfectly why our role is critical and that the banks are already using the office of the currency comptroller as a shield." The hyperbole of Mr. Spitzer's claims aside, the suit has very serious policy implications for consumer lenders and, indeed, for the very consumers who he claims to champion.

Perhaps the most important policy aspect of Mr. Spitzer's case is that, in the unlikely event it should succeed, the very mortgage market that has made housing so readily available throughout the United States to such a broad cross-section of our countrymen will be immediately imperiled. The very technology that has produced the active secondary market in mortgages and has created vehicles such as securitizations fueling this market would be incapable of contending with the erratic consumer laws of fifty states. The outcome would be a precipitous contraction of consumer credit availability (and particularly sub-prime credit to low income borrowers) and a dramatic escalation of the cost of consumer credit. The fact is that the very uniformity of these loans, offered on a nationwide basis by national banks and their subsidiaries, has created commoditized products with associated low costs. In such a market (much like the technology or telecommunications markets), consumers are the winners. Mr. Spitzer and his colleagues ignore this fact and seek to impose an indiscriminate, expensive, time-consuming, ineffective patchwork of dysfunctional "predatory lending" laws creating a state-by-state, city-by-city approach to lending, eviscerating the technological advantages from which consumers currently gain and driving legitimate, well-regulated lenders from the marketplace.

A greater danger of Mr. Spitzer's suit is the unfortunate rhetoric and irrational tendencies that have ensued. Lost in Spitzer's hyperbole is the fact that it is only the rarest of occasions that banks have been engaged in "predatory lending" and, more importantly, that bank regulators have been forceful in dealing with aberrant behavior. But, because of the populist emotions evoked by the anti-bank fervor and the attendant volley of press reports, politicians have suddenly discovered this issue and, seeking the safe ground of media approval, have embraced the emotional aspects of it while failing to appreciate the serious economic and practical flaws. Yes, there are important states' rights issues involved and perhaps some short-term impacts on the dual banking system (where state chartered banks must abide by state laws while national banks rely on the National Bank Act), but the objects of these concerns have and will continue to survive the existence of nationally chartered financial institutions, even in light of the OCC's final rule.

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