

**Federal Preemption of Federally Related Financial Institutions
- Post Watters v. Wachovia -**

Where Will The States Go Next?

P. Michael Nugent

Senior VP and General Counsel

CitiMortgage

michael.nugent@citigroup.com

What Watters v. Wachovia said

- “Beyond genuine dispute, state law may not significantly burden a national bank’s own exercise of its real estate lending power”
- “In particular, real estate lending, when conducted by a national bank, is immune from state visitorial control”
- “... state regulators cannot interfere with the ‘business of banking’ [“mortgage lending is one aspect of that business”] by subjecting national banks or their OCC-licensed operating subsidiaries to multiple audits and surveillance under rival oversight regimes.”
- Key elements of the Court’s decision:
 - » If it’s the business of banking,
 - whether conducted by a bank or one of its operating subsidiaries,
 - it’s immune from state regulation.
 - » Any regulation or state act that subjects a national bank’s conduct of the business of banking to the visitorial powers of the state is prohibited.

Possible state responses to Watters v. Wachovia

- Is mortgage servicing and purchasing, key elements of mortgage banking today, vulnerable?
 - » SC did expressly turn its decision on “the business of banking” no matter how conducted by a national bank, through an op sub or otherwise.
 - and it is mortgage lending that is an express part of “the business of banking”
 - » If you lend, you must service the loan or have serviced the loan. Servicing is a critical and core part of the “business of banking.”
 - » If you lend, you must have the capital to lend and a key element of raising capital is selling and purchasing loans. Purchasing is a critical part of the “business of banking” and, for that matter, is treated as such by most state law which, in conferring a license to lend, confers with that a license to purchase and sell loans.

Possible state response to Watters v. Wachovia:

- Might states seek to regulate national banks and their op subs indirectly, via their agents or settlement service providers generally?
 - » Brokers: see California Finance Lender Law
 - Brokers licensed as CFLs can only refer loans to lenders that have a CFL or some other license.
 - Exemptions do exist, but not for op subs of national banks
 - CFL License requirements have procedural and system impact for a lender
 - Even if the referral provisions of the CFL are found unlawful post-Watters, brokers in California still must comply with the requirements of the CFL (or other licensing law) which, in turn, impose conditions on lenders
 - › Broker disclosure requirements
 - › Fee Limitations
 - › Borrower statement requirements
 - » Brokers and Recordors: see Illinois Predatory Lending Database Pilot Law
 - Obligates all brokers and state-license lenders
 - Through requirements on brokers and country recordors, lenders are restricted.
 - › Borrower counseling requirements prior to closing
 - › Mandatory submission of borrower and lender information to state database
 - › Recordors cannot record title unless Certificate of Broker Compliance or Lender Exemption is filed along with or soon after the mortgage recordation.

- » In-state agents acting for and on behalf of out-of-state lenders: see *Bankwest v. Baker*
 - 11th circuit decision finding that the State of Georgia may regulate certain agency agreements between in-state payday stores and out-of-state banks.
 - There is broad dicta about a state's right to (1) regulate agency arrangements between an out-of-state bank (in this case, having FDIA pre-emption) and an in-state agent, (2) require certain entities to be licensed and out-of-state banks to use such licensed entities in order to do business in-state and (3) punish out-of-state entities who aid and abet in-state agents acting without license where license is required or acting in violation of their in-state license.
- » Credit triggers example in California:
 - SB 954: state licensees originating mortgage loans and requesting a credit file report in California must disclose to the borrower the potential for the consumer's name, address, phone number and significant personal information including score range to be added to marketing lists being sold by the Consumer Reporting Agencies to third parties for the purpose of the making of unsolicited "firm offers of credit or insurance."
 - No FCRA preemption.