

Financial Services and Products ADVISORY

July 1, 2009

National Banks and State Enforcement: Supreme Court Opens the Door for State Judicial Enforcement Actions

On Monday, the U.S. Supreme Court ruled, in a 5-4 decision, that states may take action through the judicial process to enforce non-pre-empted state laws against national banks. The decision, *Cuomo v. Clearing House Association, L.L.C.*,¹ seems likely to result in increased state actions against national banks (and probably federal thrifts). The decision does not alter the scope of a national bank's current compliance and other duties. *Cuomo* also is likely to affect both state and federal enforcement work.

The Decision

The *Cuomo* case arose from a request for loan file data to several national banks from the New York attorney general, for documents relating to a fair lending inquiry under state law. Implicit in the request was that non-compliance would result in an administrative subpoena issued by the attorney general's office. The banks obtained an injunction in the U.S. District Court for the Southern District of New York against enforcement of the request by the attorney general. The district court action was based on a provision in the "visitorial powers" regulation of the Office of the Comptroller of the Currency (OCC). In pertinent part, the OCC regulation bars state officials from exercising "visitorial powers" with respect to national banks and defines "visitorial powers" to include "prosecuting enforcement actions, except in limited circumstances authorized by federal law." The U.S. Court of Appeals for Second Circuit affirmed the full scope of the injunction, holding that the visitorial powers regulation was a permissible exercise of the OCC's authority.²

The question taken up by the Supreme Court was whether the visitorial powers regulation purporting to pre-empt state enforcement law was consistent with the National Bank Act. Section 484(a) of the National Bank Act provides in relevant part that "no national bank shall be subject to any visitorial powers except as authorized by federal law." The OCC regulation interprets "visitorial powers" to include the prosecution of enforcement actions.

The *Cuomo* decision construes "visitorial powers" more narrowly, as a concept distinct from, and not including, judicial enforcement actions. According to the Court, "visitorial powers" refers to "a sovereign's supervisory powers over corporations." These powers include "any form of administrative oversight that allows a sovereign to inspect books and records on demand, even if the process is mediated by a court through prerogative writs or similar means." By contrast, when "a state attorney general brings suit to enforce state law against a national bank, he is not acting in the role of sovereign-as-supervisor, but rather in the role of sovereign-as-law-enforcer."

¹ No. 08-453 (June 29, 2009).

² *Cuomo v. Clearing House Ass'n*, 510 F.3d 105 (2d Cir. 2007).

Cuomo does not hold, however, that the states have full-blown authority to enforce state laws against national banks in any manner they see fit. The decision is explicit that state enforcement powers extend only to state laws that have not been substantively pre-empted. Further, because the distinction between visitatorial powers and enforcement authority rests on the difference between the broad oversight authority of the executive branch of government and the specific judicial powers, *Cuomo* makes clear that state enforcement power is limited to actions pursued through the judicial system, and not administratively. Accordingly, the Court affirmed the injunction as to the attorney general's executive subpoenas and vacated it only as to the attorney general's authority to bring judicial enforcement actions.

Importantly, *Cuomo* does not modify the Supreme Court's most recent preemption decision involving national banks, *Watters v. Wachovia Bank, N.A.*³ *Watters* held that a state licensing regime for mortgage lenders was pre-empted not only with respect to a national bank, but also to an operating subsidiary of a national bank. *Cuomo* does not purport to be a pre-emption decision and distinguishes *Watters* as a case involving only the question of whether federal preemption extended to an operating subsidiary of the bank.

Impact

The decision is likely to have noteworthy effects on enforcement actions by both state attorneys general and the OCC, and on other litigation.

State Enforcement Action. With the removal of constraints on state judicial enforcement actions, federally chartered institutions could well generate a wave of state proceedings, as pent-up investigations are released. Many state statutes that would authorize state judicial action against national banks have not been pre-empted and would provide the legal basis for such action. Certainly, the fair lending factual context of the New York investigation in *Cuomo* is an area where other state attorneys general may push forward. The politically charged environment for investigations into mortgage lending patterns to minorities and scrutiny of Home Mortgage Disclosure Act data is likely to lead the state enforcement agenda.

The boost that *Cuomo* may give to state attorneys general is not unmitigated, however, and restrictions remain. *Cuomo* is limited to judicial actions and does not re-invigorate state administrative proceedings. Thus the wide-ranging state administrative subpoenas remain out of bounds with respect to national banks. State attorneys general will be required to file a complaint before a subpoena may be served. This limitation in turn should reduce some of the leverage that state attorneys general have had in the past.

Joint OCC and State Authority. *Cuomo* leaves untouched the OCC's enforcement powers under section 8 of the Federal Deposit Insurance Act, as well as other enforcement authority. This continued power will lead to an interesting dynamic with state enforcement efforts. The OCC conducts its enforcement work through an administrative process, supported by the agency's access to information in its examination and supervision capacity. The OCC has its own subpoena authority, but it is not always the central feature of an OCC investigation. Further, the OCC administrative process usually (but not always) will move more quickly than a judicial process.

³ 550 U.S.1 (2007).

Accordingly, the OCC's enforcement process generally will remain the more efficient route for enforcement—assuming that the OCC and the states can agree on the underlying violation and the magnitude of remedies. The states will, of course, be able to exercise their authority, but, in combination, the OCC and the state attorneys general are likely to have the greatest leverage in settlement negotiations. Joint FDIC, Federal Reserve and state actions already exhibit the power of combined efforts. The same dynamic should emerge as a result of the lifting of restraints on state enforcement action by *Cuomo*.

The incentive for federal-state cooperation may be enhanced by the consumer protection legislation proposed yesterday by the Treasury Department. The proposal effectively confirms the holding in *Cuomo*—but, importantly, it requires a state attorney general to consult with a federal agency, a new Consumer Financial Protection Agency, before filing an enforcement action. (The new agency would take over primary responsibility for compliance actions by the federal banking agencies, but these agencies would retain back-up authority.)

Federal Thrifts. *Cuomo* does not directly address the authority of states to take judicial enforcement action against federal savings associations because the Office of Thrift Supervision (OTS) does not have the same specific visitorial powers as the OCC. Nevertheless, federal thrifts likely now are in the same position as national banks. Despite the absence of a grant of visitorial powers, OTS is authorized to examine and regulate the affairs of federal thrifts, a power that the Supreme Court has construed broadly. Relying on this authority, OTS has promulgated two preemption regulations—neither of which expressly limits state enforcement actions, as the OCC visitorial powers regulation attempted to do. Accordingly, any OTS effort to preclude state enforcement actions could be challenged on the theory that regulation and examination authority does not, by its clear language, address enforcement proceedings. In any case, the OTS regulations do not appear to bar these actions.

Future Pre-emption Litigation. The *Cuomo* decision does not mark the end of litigation involving the application of state consumer protection laws to national banks and federal savings associations. Indeed, by opening up the possibility of increased state judicial enforcement actions, *Cuomo* creates an incentive for federally chartered depository institutions to challenge the underlying substantive law.

If you would like to receive future *Financial Services and Products Advisories* electronically, please forward your contact information including e-mail address to financialservices@alston.com. Be sure to put "**subscribe**" in the subject line.

Please visit our blog at <http://www.alston.com/financialmarketscrisisblog>.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any one of the following.

Mary C. Gill
mary.gill@alston.com
404.881.7276

Matthew P. McGuire
matt.mcguire@alston.com
919.862.2279

Jeffrey L. Hare
jeffrey.hare@alston.com
202.239.3902

Dwight C. Smith, III
dwight.smith@alston.com
202.756.3325

Frank A. Hirsch, Jr.
frank.hirsch@alston.com
919.862.2278

Joseph Yesutis
joseph.yesutis@alston.com
202.756.3350

John L. Latham
john.latham@alston.com
404.881.7915

ATLANTA

One Atlantic Center
1201 West Peachtree Street
Atlanta, GA 30309-3424
404.881.7000

CHARLOTTE

Bank of America Plaza
Suite 4000
101 South Tryon Street
Charlotte, NC 28280-4000
704.444.1000

DALLAS

Chase Tower
Suite 3601
2200 Ross Avenue
Dallas, TX 75201
214.922.3400

LOS ANGELES

333 South Hope Street
16th Floor
Los Angeles, CA 90071-3004
213.576.1000

NEW YORK

90 Park Avenue
New York, NY 10016-1387
212.210.9400

RESEARCH TRIANGLE

Suite 600
3201 Beechleaf Court
Raleigh, NC 27604-1062
919.862.2200

SILICON VALLEY

Two Palo Alto Square
Suite 400
3000 El Camino Real
Palo Alto, CA 94306-2112
650.838.2000

VENTURA COUNTY

Suite 215
2801 Townsgate Road
Westlake Village, CA 91361
805.497.9474

WASHINGTON, D.C.

The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404
202.756.3300

www.alston.com

© Alston & Bird LLP 2009