Federal Preemption of State Banking Laws — Are Mortgages and Foreclosures Ripe for Federal Regulation?

By Dennis C. Valet

The United States famously employs a dual charter bank system in which banks may be chartered accordingly with the Federal Office of the Comptroller of the Currency or a state banking authority. Historically, the authority to charter banks on the federal level derives from the National Bank Act of 1864, which created the OCC and gave national banks several enumerated powers together with "all incidental powers as shall be necessary to carry on the business of banking."[1] Congress also gave the OCC the exclusive power to regulate and oversee national banks, but refrained from granting full field preemption, thus requiring national banks to comply with state laws and regulations which are not preempted. Naturally, numerous legal challenges followed to define the preemptory power of the OCC. These challenges accelerated after 2004 when the OCC promulgated rules identifying broad areas of banking regulation subject to preemption.[2] By February of 2004, federal preemption had expanded to include the areas of adjustable rate mortgages, usury laws, credit card fees, escrow accounts, and more. The effect of these regulations left little room for state regulation of national banks and it is no small coincidence that in 2004 JPMorgan Chase & Company and HSBC Bank converted from New York charters to federal charters.

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In 2010, to prevent or mitigate another foreclosure crisis which some lawmakers perceived to be caused by a lack of regulation and oversight, Congress passed the Dodd-Frank Act with the intended goal of returning at least some banking regulatory authority to the states, that they believed were better situated to enact consumer protection laws. Dodd-Frank enumerated the legal standard for determining when a state regulation is preempted — if it "prevents or significantly interferes with the exercise by the national bank of its powers" — and required the OCC to make preemption determinations on a case-by-case basis.[3]

DENNIS C. VALET

The result of over 150 years of incremental changes to federal banking laws is a mix of federal statutes and regulations — some expressly preempting state law by statute (e.g. interest rate exportation which allows a national bank to follow its' home state's usury laws instead of the usury laws from the borrower's state of residence[4]) and some preempting only through regulatory interpretation by the OCC (e.g. a broad preemption on state regulation of escrow accounts). In 2018, the Ninth Circuit Court of Appeals in *Lusnak v. Bank of America*[5] examined whether regulations promulgated by the OCC preempted a California law requiring every bank to pay at least two percent interest on escrow account funds. The Ninth Circuit held that because Dodd-Frank specifically envisioned the creation of state regulations regarding interest on escrow accounts, the OCC's regulations erroneously preempted the state law which did "not prevent or significantly interfere with Bank of America's exercise of its powers."[6] The dicta was more interesting and far reaching, however, as the court opined that (1) under a *Skidmore* analysis, the OCC's regulation would be entitled to "little, if any, deference," [7] (2) a bank has the burden of proving its preemption defense,[8] and (3) that the burden requires "compelling evidence of an intention to preempt." [9]

As a result of *Lusak* and the Supreme Court's refusal to grant *certiorari*, national banks arguably cannot blindly rely upon the OCC's list of preempted areas. Dodd-Frank requires an evaluation on a case-by-case basis and the OCC's interpretation may be given little, if any, deference by the courts in a legal challenge. The field of mortgage lending is left in a particularly precarious position as mortgage and foreclosure laws vary wildly amongst the individual states. For example, in New York, residential foreclosure law requires a judicial proceeding, but many states do not. In New York, deficiency judgments are permissible, but in some states, they are not. In New York, there is no post-sale right to redemption, but in some states, there is. Congress has declined to enact legislation specifically preempting these differing laws, leaving national banks with a hodgepodge of banking regulations which may or may not be preempted through the OCC's regulations.

To add more confusion to the mix, Dodd-Frank also created the Consumer Financial Protection Bureau[10] for the purpose of regulating lending and mortgage-servicing operations, but declined to preempt state regulation by including a savings clause which preserved state laws and regulations that do not directly conflict with federal consumer protection laws.[11] Dodd-Frank empowers the CFPB to make preemption determinations on a case-by-case basis, splitting regulatory guidance between the OCC and the CFPB.

The current implementation of the dual charter banking system has left national banks in the uncomfortable position where federal preemption is a "sometimes, maybe, but not always" proposition. A national bank left wondering whether a state law is preempted must seek guidance from the OCC, the CFPB, or both, guidance which increasingly may not withstand legal challenge. It is likely that Congress will turn its eye once again to financial regulations, as evidenced by the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act[12] in 2018, which reformed portions of Dodd-Frank. When they do, the question is whether Congress will commit to full federal regulation of a system that increasingly operates almost exclusively on a national and international scale.

Note: Dennis C. Valet is a senior associate at Lieb at Law, P.C. and the firm's trial attorney. Mr. Valet concentrates his practice on real estate litigation. For more information about Mr. Valet or the topic discussed in this article you may contact him at (646) 216-8009 or dennis.valet@libatlaw.com.

1 12 USC §24.
2 12 CFR Parts 7 & 34.
3 12 USC §§25b(b)(1) & (3).
4 12 USC 25b(f).
5 883 F.3d 1185.
6 Id. at 1194.
7 Id. at 1193.
8 Id. at 1191.
9 Id.
10 12 USC §53, Subchapter V.
11 12 USC §5551.
12 Public Law No: 115-174 (05/24/2018).

The Restored Factor: What it is and How it Can Bite Your Purchaser Client Post-Closing

By Mark S. Borten

The concept of a restored factor refers to a taxing authority's ability to take a fresh look at and retroactively increase real estate taxes on residential real property benefitting from one or more exemptions. For example, John Smith owned a one-family house in Suffolk County for 20 years. John had a veteran's exemption and a senior exemption. Assume that John's *general* tax bill, covering calendar year 2019, was $2,500. Now assume that John died Jan. 1, 2019 with no surviving spouse. Both exemptions technically disappear immediately upon John's death, which is logical. Further assume that John's executor decides to sell John's house, and the sale occurs six months later, on July 2, 2019.

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Unfortunately, prior to and at the closing, the purchasers' attorney was unaware of the possible involvement of the restored factor and the need to alert the purchasers to its implications. The county assessor, however, does not learn of John's death until later in 2019 after a new deed is recorded. In January 2020, the purchasers are shocked to receive a tax bill retroactively imposing *upon them* an increased *general* tax bill restored as of John's Jan. 1, 2019 date of death, covering all of calendar year 2019. Rather than the general tax being $2,500, it is now $3,500. The distressed purchasers immediately complain to their attorney, who in frustration complains to the title company. The title company rightly notes that this is not a title issue; the tax search prepared by an independent third party disclosed both the existence of and the amount of the restored factor; and the title policy specifically excluded from coverage any title company liability for restored taxes [see ALTA Owner's Policy Exclusion 3(d) regarding liens attaching or created subsequent to the policy date].

MARK. S. BORTEN

An emotional plea from the purchaser's attorney to the seller's attorney is quickly rebuffed as not being that attorney's or the seller's problem. To avoid either being sued for malpractice or possibly facing a grievance, the purchasers' attorney reluctantly concludes that the only practical solution is for that attorney to write a check to the purchasers for the additional $1,000. Chastened, the purchaser's attorney is now privy to one of the "dirty little secrets" of transactional residential real estate, and is unfortunately far from alone in that lack of awareness.

When residential real property is sold to a person ineligible for one or more of the existing exemptions, those exemptions (perhaps excluding any Basic or Enhanced STAR exemption to which the prior owner was properly entitled) are subject to being removed by the assessor upon notice of such conveyance. This procedure is covered by Real Property Tax Law Section 520, subsection 2 of which in part directs the assessor to "forthwith assess such property at its value as of the date of transfer . . . and shall notify the new owner of the assessment." Any legitimately existing STAR exemption stays with the property for the remainder of the current assessment roll year. While there does not appear to be any "statute of limitations" precluding an assessor from theoretically going back years to restore taxes, practical limitations on that ability appear to exist. The Nassau County Department of Assessment has issued correspondence stating that such department's policy is to restore back only to the date of the deed, not the date of death. Anecdotal reports suggest bureaucratic randomness in imposing restored taxes.

How to avoid this unpleasant scenario from occurring in the future? Four options present themselves for consideration. The first and most obvious is for the purchaser's attorney to be aware of the involvement of the restored factor before closing. Checking the title report's certification page for the last conveyance date may be instructive. The second option is for the seller's attorney to hold an agreed amount (100 percent of the calculated difference, since 50 percent won't fully reimburse the purchasers) in escrow for an agreed period (say 12-18 months post-closing, until new tax bills are mailed

(continued on page 27)