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Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*

INTRODUCTION

In the fall of 2008, at the peak of the financial crisis, Oren Bar-Gill and Elizabeth Warren published a law review article proposing the creation of a new federal agency charged with protecting consumers from dangerous lending practices. Fewer than two years later, in response to the most serious challenge to the United States financial system since the Great Depression, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Adopting the idea of Bar-Gill and Warren, Dodd-Frank created the Consumer Financial Protection Bureau ("CFPB" or "Bureau"), whose mission is to ensure "that markets for consumer financial products and services are fair, transparent, and competitive." Its architects have argued that if the CFPB had been in place in the mid-2000s, it could have prevented the recent financial crisis.

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1. See Oren Bar-Gill & Elizabeth Warren, Making Credit Safer, 157 U. PA. L. REV. 1, 6 (2008). Professor Warren first proposed the idea of a consumer financial protection agency in a 2007 article where she argued for this agency using a memorable analogy:

It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house. But it is possible to refinance an existing home with a mortgage that has the same one-in-five chance of putting the family out on the street—and the mortgage won't even carry a disclosure of that fact to the homeowner.

Elizabeth Warren, Unsafe at Any Rate: If It's Good Enough for Microwaves, It's Good Enough for Mortgages, DEMOCRACY, Summer 2007, at 8, 8.


4. § 1021(a), 124 Stat. at 1979-80 (codified at 12 U.S.C.A. § 5511); see also Learn About the Bureau, CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/the-bureau/ (last visited Apr. 10, 2011) ("The central mission of the . . . Bureau is to make markets for consumer financial products and services work for Americans—whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products.

In their 2008 article, Bar-Gill and Warren argued that a new consumer financial protection agency was needed because, among other reasons, existing federal financial regulators were insufficiently motivated to focus on consumer protection. Bar-Gill and Warren also alleged that the aggressive preemption of state consumer financial protection laws by the Office of the Comptroller of the Currency ("OCC") in the 2000s weakened consumer financial protection at the state level. Throughout the past decade, consumer advocates, attorneys general, and academics have agreed, criticizing the OCC and the Office of Thrift Supervision ("OTS") for their use of preemption to prevent states from cracking down on predatory lending. For their part, the OCC and other federal regulators have defended their use of preemption, arguing that the U.S. Constitution requires preemption where state law conflicts with federal law, and that preemption is an important tool for promoting the efficient operation of credit markets. As developed more fully below, both sides of the debate make a compelling argument, creating a preemption dilemma: preemption of state consumer financial protection laws could both harm and benefit consumers.

if the agency existed ten years ago, "the subprime mortgages that were sold to families across the country and that ultimately cost so many of them their homes would never have been marketed. Without those subprime mortgages fed into the system, the housing bubble would not have inflated with such speed." Jim Puzzanghera, Q&A: Elizabeth Warren, L.A. TIMES, Oct. 27, 2010, at B1.

6. See Bar-Gill & Warren, supra note 1, at 90.

7. The OCC is a federal agency within the Treasury Department that regulates national banks in order to maintain their safety and soundness and ensure that all Americans have "fair and equal access to financial services." About the OCC, OFFICE OF THE COMPTROLLER OF THE CURRENCY, http://www.occ.treas.gov/about/index-about.html (last visited Apr. 10, 2011).


9. The OTS is another agency housed within the Treasury Department, and it is charged with regulating federally chartered thrifts (savings associations and savings banks) in order to "maintain their safety and soundness, and compliance with consumer protection laws and regulations." OTS Profile, OFFICE OF THRIFT SUPERVISION, http://www.ots.treas.gov/?p=OTOSProfile (last visited Apr. 10, 2011). Dodd-Frank eliminated the OTS and placed its authority with the OCC and the Federal Reserve. § 312(b), 124 Stat. at 1521–22 (codified at 12 U.S.C.A. § 5412).


This Recent Development examines how Dodd-Frank changes the relationship between state and federal consumer financial protection authority and helps resolve the preemption dilemma. It argues that Dodd-Frank promotes "dynamic federalism," an arrangement of governance whereby overlapping authority and competition between state and federal regulators in the area of consumer financial protection has the potential to make the preemption dilemma much less problematic. By creating a powerful new agency in the CFPB while simultaneously weakening the ability of federal regulators to preempt state consumer protection laws, Dodd-Frank creates a new framework for state and federal consumer protection authorities. This innovation in consumer financial protection should satisfy both those arguing for greater state powers to protect their citizens and those emphasizing the need for consistent, nationwide regulations in order to promote efficient credit markets.

Part I examines the recent history of preemption before Dodd-Frank, and it explains how, over the past decade, federal regulators have had broad power to preempt state consumer financial protection laws. Part II highlights how both sides of the preemption debate have well-founded positions and that admitting this creates a preemption dilemma for policymakers. Part III suggests that the creation of the CFPB by Dodd-Frank is one key component that will reorient the preemption dilemma. Part IV argues that Dodd-Frank further resolves this dilemma by weakening federal preemption while empowering state regulators, thereby promoting dynamic federalism.

I. PREEMPTION BEFORE DODD-FRANK

The doctrine of preemption stems from the Supremacy Clause of the U.S. Constitution, which makes federal law "the supreme Law of the Land." Because of the Supremacy Clause, federal law trumps, or preempts, state law when there is a conflict between the two. In the


14. See McCulloch v. Maryland, 17 U.S. 316, 330 (1819). Apart from state consumer financial laws, the subject of this Recent Development, the Supreme Court has recently been very active in holding that a wide variety of state laws have been preempted,
field of banking law, preemption is primarily based on the National Bank Act of 1864 ("NBA"), which created national banks and thereby created the country's unique dual system of state-chartered and nationally-chartered banks. The NBA gives national banks "all such incidental powers as shall be necessary to carry on the business of banking." 

In *Barnett Bank of Marion County, N.A. v. Nelson*, the Supreme Court stated its standard for preemption of state law under the NBA. *Barnett Bank* involved the question of whether a federal law allowing (but not requiring) national banks to sell insurance preempted a Florida law that prohibited national banks from selling insurance in towns populated by fewer than 5,000 people. In declaring that the Florida law in this case was preempted, the Court noted that the central question in deciding whether a federal law preempts a state law is whether Congress intended the federal law to have that effect. Only if Congress intended the federal law to preempt the state law will the Supremacy Clause require preemption. The Court then observed that there are three methods for determining Congress's intent and thus three kinds of preemption. First, there is express preemption: if the explicit language of a federal statute conflicts with state law, then the state law is preempted. Second, where this kind of express preemption is not available, the

including environmental laws, products liability laws, tobacco advertising laws, and laws regulating international trade. See Erwin Chemerinsky, *Empowering States When It Matters: A Different Approach to Preemption*, 69 BROOK. L. REV. 1313, 1314 (2004). While the Court has claimed that it starts with a presumption against preemption out of respect for the sovereignty of the states, some scholars have viewed the frequency with which the Court has found preemption of state laws that regulate business as undermining this claimed allegiance to federalism and as exposing political biases on the Court. See *id.* at 1314–15. This inconsistency has also been noted regarding members of Congress who view themselves as federalists while eagerly supporting the preemption of state laws regulating business. See Jones, supra note 12, at 114.


18. See *id.* at 33.
19. *Id.* at 27–29.
20. *Id.* at 30.
21. *Id.*
22. See *id.* at 31.
Court may apply field preemption, where it decides that the effect of a federal law is so pervasive that it leaves no room for the operation of a certain category of state laws. Finally, the Court stated that it will infer Congress’s intent that a federal law preempts a state law if there is an “irreconcilable conflict” between the two. These three tests for whether preemption applies have been part of the Supreme Court’s jurisprudence for decades. In what was the most relevant holding from Barnett Bank for purposes of this Recent Development, the Court held that when the NBA or another federal law relating to the powers of national banks does not explicitly preempt a state law, the Court would apply the third kind of preemption—conflict preemption—instead of field preemption. It then interpreted a conflict between a state law and a federal banking law to exist where the state law would “prevent or significantly interfere with the national bank’s exercise of its powers” as determined by federal law. If such a conflict exists, the state law must be preempted. The Court in Barnett Bank found that although the Florida law denying national banks the power to sell insurance did not directly contradict the federal statute, it did serve as an obstacle to a power that Congress intended to confer on national banks.

The standard of preemption in banking law established in Barnett Bank became a major source of contention in the early 2000s.

23. See id. Field preemption involves the carving out of a group of state laws that fall under a certain category, such as lending laws. See, e.g., Arthur E. Wilmarth, Jr., The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection, 23 ANN. REV. BANKING & FIN. L. 225, 233–37 (2004) (arguing that the OCC's 2004 preemption regulation constituted de facto field preemption of state laws that regulated the lending powers of national banks). As discussed further in this Part, before Dodd-Frank, the OTS had claimed field preemption of state laws affecting the lending powers of federal savings associations. See 12 C.F.R. § 560.2(a) (2010).

26. Barnett Bank, 517 U.S. at 31 (“In this case we must ask whether or not the Federal and State Statutes are in ‘irreconcilable conflict.’” (quoting Rice v. Norman Williams Co., 458 U.S. 654, 659 (1982)). In Gade v. National Solid Wastes Management Ass'n, the Court usefully elaborated on conflict preemption, explaining that absence explicit pre-emptive language, we have recognized at least two types of implied pre-emption: field preemption ... and conflict preemption, where compliance with both federal and state regulations is a physical impossibility, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

505 U.S. 88, 98 (1992) (internal citations and quotation marks omitted).
27. Barnett Bank, 517 U.S. at 33.
28. Id. at 31.
During that period the OCC took a tough stance toward state antipredatory lending laws, leading to increasing acrimony between the OCC and the states. The most visible example of the growing conflict between states and the OCC was the OCC's 2003 preemption of the Georgia Fair Lending Act ("GFLA"). The GFLA was modeled on the North Carolina Predatory Lending Act ("NCPLA"), which was enacted in 1999 and was the first such law in the nation. The NCPLA included restrictions on "high cost" mortgages as well as various prohibitions on predatory lending practices such as "flipping" a loan and encouraging default in connection with refinancing the loan. North Carolina passed this legislation in response to the harm that predatory lenders were causing residents of the state and the perceived weakness of federal laws in responding to this problem. When the GFLA was enacted in 2002, it was the strongest antipredatory lending law in the nation. While containing many of the same provisions as the NCPLA, the GFLA went beyond North Carolina's law by prohibiting certain kinds of late fees, prohibiting foreclosure without written notice, and requiring arbitration in a forum that is convenient to the borrower.

29. See Berner & Grow, supra note 10, at 36 (quoting North Carolina Attorney General Roy Cooper's accusation that the OCC "took 50 sheriffs off the job during the time the mortgage lending industry was becoming the Wild West"); Eric Nalder, Mortgage System Crumbled While Regulators Josted, SEATTLE POST-INTELLIGENCER, Oct. 11, 2008, at A1 (describing the 2003 preemption by the OCC of Washington state's attempted enforcement of its Consumer Loan Act against National City Mortgage's loan practices).


33. N.C. GEN. STAT. § 24-10.2(c) (2010). "Flipping" occurs when a lender encourages a borrower to unnecessarily refinance in order to generate fees for the lender. Id.

34. § 24-10.2(d).


37. See Wookbai Kim, Challenging the Roots of the Subprime Mortgage Crisis: The OCC's Operating Subsidiaries Regulation and Watters v. Wachovia Bank, 21 LOY. CONSUMER L. REV. 278, 286 (2009); see also King, supra note 32, at 382–83 (comparing the GFLA with the NCPLA).

38. See King, supra note 32, at 382–83.
In response to the GFLA, National City Corporation of Indiana, a national bank, requested that the OCC determine whether its subprime lending subsidiary, First Franklin Financial, could continue lending in Georgia.\(^3\) In its Preemption Determination and Order, the OCC concluded that "the provisions of the GFLA affecting national banks' real estate lending are preempted by Federal law."\(^9\)\(^4\)

Tensions between the OCC and the states culminated in the promulgation of the OCC's 2004 rule supposedly clarifying the *Barnett Bank* standard of preemption.\(^4\)\(^1\) This rule declared that, apart from explicit preemption, state laws would be preempted if they "obstruct, impair, or condition" a national bank's exercise of its powers under the NBA.\(^4\)\(^2\) Further, the OCC stated in this rule that its revised preemption standards would apply to operating subsidiaries of national banks to the same extent that they apply to their parent banks;\(^4\)\(^3\) thus, state regulation of these operating subsidiaries could be preempted to the same extent as state regulation of national banks.\(^4\)\(^4\) The OCC has argued at length that its preemption determination was simply a restatement of prior Supreme Court standards, including *Barnett Bank*.\(^4\)\(^5\)

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39. See Berner & Grow, supra note 10, at 40.
41. See Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (codified at 12 C.F.R. pts. 7, 34 (2010)). This regulation also defined the OCC's visitorial powers under section 484(a) of the NBA to include "(i) Examination of a bank; (ii) Inspection of a bank's books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable federal or state laws concerning those activities." 12 C.F.R. § 7.4000 (2010). The Supreme Court rejected this interpretation of visitorial powers in finding the OCC's ability to exclude states from the enforcement of nonpreempted state laws against national banks as an "unreasonable" interpretation of their visitorial powers. See Cuomo v. Clearing House Ass'n, 129 S. Ct. 2710, 2715-20 (2009). Thus, the OCC cannot preempt a state's attempt to enforce nonpreempted state law against a national bank. Id.
42. See 12 C.F.R. § 7.4008 (2010).
43. See id. A bank's operating subsidiaries are corporations, limited liability companies, or other similar entities in which the bank has an ownership interest of greater than fifty percent. 12 C.F.R. § 5.34 (2010). An operating subsidiary of a national bank has many of the same powers as its parent bank but may not accept deposits. See generally Broome & Markham, supra note 15, at 223–24 (describing the powers of a national bank's operating subsidiaries).
44. See Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. at 1913.
45. See id. at 1910 (arguing that the standard expressed in the regulation was intended by the OCC as "the distillation of the various preemption constructs articulated by the Supreme Court . . . and not as a replacement construct that is in any way inconsistent with those standards").
Contrary to the OCC’s view of its 2004 rule, there is reason to believe that the OCC went beyond clarifying *Barnett Bank* and in fact made it much easier for the OCC to preempt state laws than the *Barnett Bank* standard would allow. In fact, the effect of the OCC’s rule was to negate the application of any state’s antipredatory lending laws to national banks and their subsidiaries, and thus it led to the de facto adoption of field preemption in this area. Strong evidence that the OCC implicitly adopted field preemption can be found in the OCC’s own assertion that “the preemption regulations adopted by the OCC are substantially identical to the preemption regulations of the [OTS] that have been applicable . . . for a number of years.” It is therefore useful to compare the OCC’s 2004 rule with the OTS’s ability to preempt state regulation. It turns out there is not much difference.

The OTS has declared that it “occupies the entire field of lending regulation for federal savings associations.” The OTS’s field preemption meant that virtually all state laws that regulated any of the lending activities of federal savings associations would be preempted by the OTS, including laws regulating licensing, terms of credit, fees, and the “[p]rocessing, origination, servicing, sale or purchase of, or investment or participation in, mortgages.” The only state laws not preempted by the OTS’s claim to field preemption were those concerning contracts, real property law, tort law, criminal law, and those laws that have “only an incidental effect on lending operations.”

While the OCC claimed that it was not adopting field preemption in its 2004 rule, the scope of the laws preempted by this rule suggests otherwise. Just as the OTS claimed preemption for a broad category of state lending laws, the OCC listed twelve kinds of lending regulation that would not apply to national banks, such as licensing and registration, loan-to-value ratios, terms of credit.

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47. For a detailed presentation of this argument, some of which is summarized below, see Wilmarth, *supra* note 23, at 234–37.


49. 12 C.F.R. § 560.2(a) (2010).

50. 12 C.F.R. § 560.2(b).

51. Id.

52. See Wilmarth, *supra* note 23, at 234.
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(including amortization and minimum payments), the use of credit reports, disclosure and advertising, and processing, origination, or servicing mortgages.53 Furthermore, the limited state laws that the OCC said would not be preempted included contract, criminal, and tort law, or those laws which "the OCC determines to be incidental to the real estate lending operations of national banks."54 The OCC's decision to establish specific areas of state regulation as preempted, while simultaneously acknowledging other areas that are not, strongly resembles the OTS's field preemption rule.55

As this Part demonstrates, federal regulators have had wide latitude over the past decade to preempt state laws regulating national banks and thrifts. The OCC's 2004 preemption rule, in particular, sparked a fierce debate about the wisdom of federal regulators applying such a broad preemption power to the states. The next Part discusses this debate and argues that preemption presents policymakers with a difficult dilemma since both sides have legitimate concerns.

II. THE PREEMPTION DILEMMA: EFFICIENCY VERSUS STRONG CONSUMER PROTECTION

During the past decade, a debate has arisen over what might be called a preemption dilemma. On one side there are those who support the ability of federal regulators to prevent state laws from applying to national banks and thrifts.56 Adherents believe that federal regulators should have strong preemption powers not only because of constitutional concerns, but also for economic reasons: clear, consistent, nationwide laws and regulations promote efficiency and reduce the cost of credit for consumers.57 Opponents, however, hold that states ought to have the ability to implement strong consumer protection laws because federal regulators cannot be trusted to do a good job protecting consumers.58 If these two arguments are true, a dilemma follows: federal preemption of strong state consumer protection laws both helps and hurts consumers. As it turns out, there are good reasons for both positions, or, at the very

53. See 12 C.F.R. § 34.4 (2010).
54. Id.
55. See 12 C.F.R. § 560.2(b).
58. See Wilmarth, supra note 23, at 232.
least, there is not strong evidence that either side of the debate is wrong.

A. How Preemption Benefits Consumers

There are several economic benefits alleged to result from federal preemption of state regulations of national banks and thrifts. First, preemption can promote competition by preventing states from protecting certain kinds of domestic industries and companies. For example, the OCC has sent letters to states warning them of conflicts with federal laws when states have tried to restrict out-of-state national banks from selling annuities, acting as fiduciaries, and opening ATMs. Each of these restrictions would have likely caused increased cost or inconvenience to consumers as a result of limiting the ability of out-of-state national banks to compete with local banks. Second, as a result of the nature of interstate banking, various OCC officials have argued for uniform, nationwide banking laws in order to promote efficiency by reducing compliance costs. A senior economic advisor at the OCC has presented empirical evidence that preemption has been especially beneficial for smaller interstate national bank holding companies. Although this researcher acknowledged that there are relatively few empirical studies on the cost effects of banking regulations, there is evidence that banks have substantial compliance costs when they must respond to state regulation. Even Professors Warren and Bar-Gill, who criticized the effects of federal preemption over the past decade, have acknowledged that "[i]n an era of interstate banking, uniform regulation of consumer credit products at the federal level may well

59. See Mason et al., supra note 57, at 793.
60. See id. at 793–94.
61. See id.
62. See Dugan, supra note 56, at 7–9; see also Julie L. Williams & Michael S. Bylsma, Federal Preemption and Federal Banking Agency Responses to Predatory Lending, 59 BUS. LAW. 1193, 1201 (2004) (discussing the OCC’s approach to combating predatory lending through “the extensive, comprehensive supervisory systems it administers for national banks”).
64. See id. at 7.
65. See id. at 8. These costs are largely based on the need for highly trained legal and management staff for compliance. See id.
be more efficient than a litany of consumer protection rules that vary from state to state."  

Some have suggested that the OCC has a self-interested motive in arguing that it needs federal preemption in order to promote uniform, nationwide laws for national banks, since its funding comes from assessments on the national banks that it regulates. The allegation is that because the OCC wants to keep as many banks with a national charter as possible and attract more banks to a national charter, it has chosen to take a very strong stance on preemption in order to make the national charter more attractive. However, a report by the Government Accountability Office found that there is no evidence showing that preemption plays a role in a bank deciding to adopt a national charter over a state charter. Furthermore, assuming for the sake of argument that the OCC has a self-interested reason to preempt state laws, the OCC still has a sound economic rationale for preemption. Even state regulators who have argued for stronger state consumer protection laws have agreed with national banks that preemption promotes efficiency in the banking industry. Thus, the OCC appears to have had legitimate economic reasons to preempt state laws that conflicted with federal laws. However, while the OCC has had a strong economic rationale for preemption, there is little doubt that preemption has harmed consumers.

B. How Preemption Has Harmed Consumers

The other side of the debate is that federal preemption of state consumer financial protection laws has harmed consumers. First, there are federalism concerns about preemption. While there is no

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66. Bar-Gill & Warren, supra note 1, at 83.

67. See Wilmarth, supra note 23, at 232.

68. See id.

69. See U.S. Gov't Accountability Office, GAO-06-387, OCC Preemption Rules: OCC Should Further Clarify the Applicability of State Consumer Protection Laws to National Banks 9 (2006) ("Based on our work, no conclusion can be made about the role, if any, the preemption rules had . . . on future charter choices.").

70. See id. at 33.

71. See Julia Patterson Forrester, Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders, 74 U. CIN. L. REV. 1303, 1359–62 (2006); see also Keith R. Fisher, Toward a Basal Tenth Amendment: A Riposte to National Bank Preemption of State Consumer Protection Laws, 29 HARV. J.L. & PUB. POL’Y 981, 1030–32 (2006) (arguing that principles of federalism that have been applied to the interaction of federal courts and state courts, such as comity and state sovereignty, are analogous to the interaction between federal and state regulation of the financial industry).
doubt that Congress has the constitutional authority to preempt conflicting state laws, the question is whether Congress should use this authority in the case of consumer finance.\textsuperscript{72} Local authorities, such as mayors, governors, and attorneys general, will likely be more responsive to consumers in their states than the federal government, since they will more easily hear whether these consumers are being harmed by financial products and practices.\textsuperscript{73} Also, a strong power of preemption will remove the "laboratories of democracy" effect of state regulation, and thus stifle consumer protection innovation.\textsuperscript{74} It is implausible that the federal government will always know the best solutions for consumer financial protection, especially considering the varying needs of a large and diverse nation like the United States.\textsuperscript{75}

There is also empirical evidence supporting the view that federal preemption of state consumer financial protection laws has harmed consumers. In one study, researchers found that the OCC's 2004 preemption rule was followed by an increase in loan defaults as well as riskier lending in those states whose antipredatory lending laws were preempted, and it concluded that federal preemption has likely been a cause of the foreclosure crisis.\textsuperscript{76} Notably, this study also found that loans made by OCC-regulated mortgage lenders had a higher rate of default than independent mortgage companies in states where antipredatory lending laws were preempted.\textsuperscript{77}

Furthermore, there is evidence supporting the concern that the federal government has not been able to adequately protect consumers, and that preemption of state laws has removed badly needed regulation.\textsuperscript{78} Professor Patricia McCoy testified before the

\textsuperscript{72} See Forrester, supra note 71, at 1359.

\textsuperscript{73} See id. at 1361–62. The recent scandal involving national banks signing off on foreclosures without adequately reviewing the paperwork is one compelling example of how state regulators were faster to identify and respond to this problem than the federal regulators. See Zachary A. Goldfarb, Regulators Flawed in Foreclosure Oversight, WASH. POST, Nov. 8, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/11/07/AR2010110704301.html?hpid=topnews.

\textsuperscript{74} See Chemerinsky, supra note 14, at 1324–25. North Carolina, for example, has been an innovator in consumer financial protection, inspiring other states to follow its lead. As discussed already, North Carolina was the first state in the nation to pass an antipredatory lending law. See supra text accompanying notes 31–35.

\textsuperscript{75} See Forrester, supra note 71, at 1360–61.

\textsuperscript{76} See Lei Ding et al., CTR. FOR CMTY. CAPITAL, UNIV. OF N.C. AT CHAPEL HILL, THE IMPACT OF FEDERAL PREEMPTION OF STATE ANTI-PREDATORY LENDING LAWS ON THE FORECLOSURE CRISIS 5 (2010).

\textsuperscript{77} See id.

U.S. House Committee on Financial Services that five of the seven largest failures of depository institutions in 2007 and 2008 were thrifts regulated by the OTS, and their failures were in significant part due to risky loans, including option adjustable rate mortgages ("ARMs") and "low documentation" and "no documentation" ARMs.79 A notable case study in this area was the collapse of Washington Mutual Bank, the largest depository institution to fail in U.S. history.80 The OTS never issued binding rules requiring thrifts to stop their predatory lending practices; instead, it merely engaged in "light touch" regulation—as Professor McCoy put it—consisting of guidelines, examinations, and informal agreements.81 The largest thrifts ignored the OTS’s "light touch" regulation, however, and continued their predatory practices.82

Unlike the OTS, the OCC did issue a rule banning loans that primarily relied on collateral and were not based on the borrower’s ability to repay the loan.83 Professor McCoy testified, however, that the rule was "vague in design and execution," and that national banks and their subsidiaries mostly ignored it.84 Furthermore, contrary to the OCC's assertion that national banks were not substantially involved in predatory lending,85 Professor McCoy testified that, in 2005, the five largest national banks—Bank of America, JP Morgan Chase Bank, Citibank, Wachovia Bank, and Wells Fargo—were all involved in low documentation and no documentation loans, and they ended up suffering substantial losses as a result of this activity.86 The OCC's inadequate protection of consumers is shown dramatically by the lack of enforcement measures that the OCC took to confront abusive lending practices: of the 495 enforcement actions between

80. See McCoy Testimony, supra note 78, at 12.
81. See id.
82. See id.
83. See 12 C.F.R. § 34.3 (2010).
84. See McCoy Testimony, supra note 78, at 13.
86. See McCoy Testimony, supra note 78, at 13–14.
2000 and 2006, only one concerned subprime lending. Moreover, despite publishing an Interagency Guidance on Nontraditional Mortgage Product Risks in 2006, it appears that the OCC’s guidance was largely ignored. As the former senior vice president of the Center for Responsible Lending, Eric Stein, testified to Congress, “Countrywide booked $161 billion in payment option ARM loans while it was under the watch of the OCC, but 86% of those loans could not meet the interagency guidelines.”

The considerations discussed above suggest that Bar-Gill and Warren were correct when they stated that federal preemption would not have been such a problem if the federal regulators had been more aggressive in protecting consumers from harmful financial practices. The dilemma that preemption presented for federal regulators was in large part a consequence of federal inaction. However, the preemption dilemma—as well as the debate about preemption—is likely to change significantly in the future. There is reason to believe that Dodd-Frank creates a state and federal structure that promotes the economic values underlying preemption while at the same time promising stronger consumer financial protections. This Recent Development next discusses changes that Dodd-Frank makes to consumer financial protection at the federal level, and how this change helps resolve the preemption dilemma.

III. HOW THE CONSUMER FINANCIAL PROTECTION BUREAU HELPS RESOLVE THE PREEMPTION DILEMMA

An interesting consequence of Dodd-Frank’s enactment is that preemption will no longer pose as severe a dilemma as it has recently. This view of the effect of Dodd-Frank on consumer financial protection is based on two premises. First, the CFPB will have substantial authority to enact and enforce tough, nationwide consumer protections. Thus, the regulations it issues have the potential to protect consumers without the economic costs usually associated with state consumer protection. Because it is likely that this agency will pursue stronger federal consumer financial protection regulations and enforcement than in the past, there will be less urgency for such laws at the state level. Second, Dodd-Frank has given the states a substantial role in consumer protection, so they can

87. See Berner & Grow, supra note 10, at 36.
88. See Stein Testimony, supra note 79, at 22.
89. Id. (emphasis added).
90. See Bar-Gill & Warren, supra note 1, at 83.
serve as a second line of defense for consumers if federal regulation proves to be ineffective or inadequate. Consequently, Dodd-Frank restores some balance to the interaction of federal and state consumer financial protection authority, and the new regulatory structure it creates promises to make the preemption dilemma much less challenging. This Part analyzes how the creation of the CFPB helps resolve the preemption dilemma by strengthening federal consumer financial protection.

A. A Regulator with Motivation and Authority

The CFPB will be an independent agency housed within the Federal Reserve System ("FRS"). It will come into existence on the "designated transfer date," July 21, 2011, when the consumer protection authority of the other federal financial regulators will be transferred to the Bureau. Until that time, the secretary of the treasury is responsible for setting up the CFPB. Although there has been speculation that political opponents of the CFPB will try to weaken or even eliminate the Bureau, the likelihood of these opponents succeeding is small.

The primary mission of the CFPB is to "implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that [these markets] are fair, transparent, and competitive." By focusing solely on consumer

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92. See Cheyenne Hopkins, Date Set for Shift in Regs, Am. Banker, Sept. 21, 2010, at 4, 4. Federal agencies such as the OCC, Federal Deposit Insurance Corporation ("FDIC"), OTS, and others that were responsible for enforcing federal consumer financial protection laws before Dodd-Frank will continue exercising this authority until the designated transfer date. Carpenter, supra note 91, at 2.
94. See Brady Dennis, Republicans Target Regulatory Overhaul, Wash. Post, Dec. 25, 2010, at A14. One reason why Dodd-Frank is unlikely to be repealed or significantly changed in the near future is that it has proven to be very popular with the public. A Gallup poll revealed that sixty-one percent of Americans approve of the legislation and thirty-seven percent disapprove. Lydia Saad, Among Recent Bills, Financial Reform a Lone Plus for Congress, Gallup (Sept. 13, 2010), http://www.gallup.com/poll/142967/ among-recent-bills-financial-reform-lone-plus-congress.aspx.
protection, the Bureau promises to be much more effective at preventing the kind of abusive lending practices to which the OCC and the OTS were slow to respond. Moreover, the CFPB consolidates the enforcement of existing federal consumer protection laws that deal with financial products and services. These include the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Homeownership and Equity Protection Act of 1994, and the Truth in Lending Act ("TILA"), to name just a few of over a dozen federal laws. Unlike in the past, when responsibility for enforcing consumer financial protection laws was given to regulators whose primary mission was not consumer protection, a single regulator, the CFPB, is now responsible for enforcing these laws. This will make enforcement of these laws occur faster and more frequently, thereby reducing the lag time between innovation in the financial industry and regulatory responses.

In order to achieve its mission, the CFPB has authority to regulate a wide range of financial products and services including extensions of credit, servicing loans, debt collection, taking deposits, check cashing, credit counseling, debt management, and credit report services. The entities over which the CFPB will be the primary consumer protection regulator include depository institutions with assets greater than $10 billion as well as certain nondepository institutions such as mortgage servicers and originators, loan modification or foreclosure relief services, and payday lenders. The financial regulators that have traditionally had consumer protection authority (such as the OCC and the Federal Deposit Insurance Corporation ("FDIC")) will continue to have this authority over those financial entities not covered by the CFPB, such as depository institutions with assets less than $10 billion.

The CFPB’s core consumer protection functions will include rulemaking, enforcement, and oversight. Dodd-Frank gives the

96. See Carpenter, supra note 91, at 5–6.
97. See id. at 6.
98. See Bar-Gill & Warren, supra note 1, at 90 ("These agencies are designed with a primary mission to protect the safety and soundness of the banking system. This means protecting banks’ profitability. Consumer protection is, at best, a lesser priority that consists largely of enforcing Truth-in-Lending disclosure rules.").
102. Carpenter, supra note 91, at 8.
103. See generally id. (providing a detailed overview of the CFPB’s powers in each of
Bureau the power to “prescribe rules and issue orders and guidance, as may be necessary or appropriate . . . to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.”\textsuperscript{105} In addition to the Bureau’s power to adopt rules enforcing federal consumer financial laws that are already enacted, Dodd-Frank gives the Bureau the power to prohibit “unfair, deceptive, or abusive” acts or practices in the financial industry.\textsuperscript{106} The CFPB can only designate an act or practice as “unfair” if it causes or is likely to cause “substantial injury” to consumers and is not “reasonably avoidable” by consumers, and if this injury is not “outweighed by countervailing benefits to consumers or to competition.”\textsuperscript{107} An “abusive” act or practice is one that “materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service” or that takes “unreasonable advantage” of a consumer’s misunderstanding, reasonable reliance, or inability to protect his or her own interests.\textsuperscript{108} In order to enforce the federal consumer financial laws and the rules that the CFPB adopts, the Bureau may initiate investigations of financial companies and issue subpoenas.\textsuperscript{109} Further, the CFPB may initiate civil actions in federal court against companies believed to have violated the Bureau’s rules or federal consumer financial laws.\textsuperscript{110} Dodd-Frank also gives the CFPB the authority to seek civil penalties for violations of these regulations and laws.\textsuperscript{111} As for oversight, the CFPB has the power to examine and require reports from financial entities that it regulates.\textsuperscript{112}

The Bureau promises to have a large budget, increasing the likelihood it will be effective in exercising its powers. Dodd-Frank allows the CFPB to take a maximum of 10% of the FRS’s total operating expenses in fiscal year (“FY”) 2011, 11% in FY 2012, and 12% thereafter.\textsuperscript{113} In FY 2009, the FRS’s total operating expenses

\begin{footnotesize}
112. See CARPENTER, supra note 91, at 5.
113. § 1017(a), 124 Stat. at 1975–78 (codified at 12 U.S.C.A. § 5497). The precise mechanism for funding the Bureau is not entirely clear from the statute, but it appears to give the director of the Bureau significant control over the process:

Each year (or quarter of such year), beginning on the designated transfer date, and
were $4.98 billion, so 10% would be approximately $500 million. By comparison, for FY 2010, Congress appropriated $291.7 million for the Federal Trade Commission ("FTC"). Unlike the CFPB, only part of the FTC is focused on consumer protection, since its other major function is to focus on antitrust and competition issues. Finally, if the director of the CFPB determines that the funding level provided by the FRS is insufficient for the Bureau to effectively exercise its authority, a provision in Dodd-Frank authorizes additional appropriations up to $200 million for fiscal years 2010 through 2014. But just as important as the size of the agency’s budget, the funding mechanism for the CFPB cannot be reviewed by Congress, so the Bureau’s funding is largely independent of politics.

Given the CFPB’s sweeping powers to enforce consumer financial laws and regulations, and given the significant resources provided to the Bureau that cannot be threatened by Congress’s appropriations process, the Bureau has the potential to be a powerful federal agency. If it turns out to be effective, the CFPB could help resolve the bitter preemption debates of the past decade. Addressing the concerns of one side of the preemption debate, the extensive power of the CFPB and its potential to be an effective federal

each quarter thereafter, the Board of Governors shall transfer to the Bureau from the combined earnings of the Federal Reserve System, the amount determined by the Director to be reasonably necessary to carry out the authorities of the Bureau under Federal consumer financial law, taking into account such other sums made available to the Bureau from the preceding year (or quarter of such year).

Id. The use of the word “shall” in reference to the Board of Governors’ transfer of funds to the Bureau suggests that the board cannot veto or provide less than the amount of funds that the director determines is “reasonably necessary” for the agency to effectively exercise its authority.

114. See CARPENTER, supra note 91, at 5.
115. See FED. TRADE COMM’N, FISCAL YEAR 2011 BUDGET JUSTIFICATION SUMMARY 38 (2010). The Bureau’s budget will still be small in comparison with other federal agencies. The Environmental Protection Agency’s enacted budget for FY 2010 was $10.3 billion. EPA’s Budget and Spending, ENVTL. PROT. AGENCY, http://www.epa.gov/planandbudget/budget.html (last updated Apr. 7, 2011). Of course, the budget for both of these agencies is miniscule in comparison to the Department of Defense’s enacted budget for FY 2010, which was $660.3 billion. U.S. DEP’T OF DEF., FISCAL YEAR 2011 BUDGET REQUEST 1–2 (2010).
119. Discussing the CFPB, Ed Yingling, the president and chief executive of the American Bankers Association, has stated that “[i]n many ways, it is the most powerful agency ever created.” Last Week in Words, AM. BANKER, Jan. 3, 2011, at 2, 2. While this statement may be too strong, it provides insight into how banking leaders view the CFPB.
regulator should satisfy consumer protection advocates and state attorneys general who have felt compelled to act to fill the gaps created by weak federal regulation. As further explained below, the CFPB will be much more receptive to concerns about consumer protection raised at the state level than the OCC or the OTS were. At the same time, the CFPB will address the concerns of the other side of the preemption debate: nationwide laws and regulations enforced by the CFPB will have the consistency and uniformity that supporters of preemption have argued were lacking in state consumer protection laws. Despite these benefits of the CFPB, there are several serious objections to the argument that the CFPB can help resolve the preemption dilemma.

B. Worries About New Efficiency Problems, the FSOC, and Agency Capture

One potential objection to the argument that the CFPB will help resolve the preemption dilemma is that, under Dodd-Frank, the CFPB provides a floor rather than a ceiling on consumer financial protection regulation. Section 1041(a)(2) states that "a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title."120 This provision is somewhat unclear,121 but it arguably means that if a state's consumer financial protection laws are stronger than any laws or regulations that the CFPB may enforce, then that state law will not be preempted by any federal consumer laws in Dodd-Frank or rules promulgated by the CFPB based on those laws.122 If this is the case, then there is a possibility of a patchwork of consumer protection laws across all fifty states, seemingly undermining the claim here that Dodd-Frank can help promote uniformity in consumer financial protection law.

In response to this objection, the argument of this Recent Development is not that Dodd-Frank will completely eliminate the

120. Id.
121. For example, as more fully developed below, it is unclear how section 1041(a)(2) relates to the preemption provisions that concern the NBA and the Home Owners Loan Act ("HOLA") in sections 1044 and 1046, respectively. It is also unclear whether section 1041(a)(2) means that those more protective state laws are entirely protected from preemption, since section 1041(a) does not mention preemption.
efficiency problems associated with laws that vary from state to state. Rather, because of the power given to the CFPB by Dodd-Frank, this agency will have the capacity to pass and enforce strong regulations that will increase the effectiveness of federal regulation of the financial industry and thereby reduce the need for state regulation. As a result, the need for federal regulators to preempt state law will decline, and the dilemma that preemption presents will not be as significant. Although improved federal regulation promises to reduce the need for state laws, it will not by any means eliminate the importance of state regulation, or eliminate inconsistency between such laws from state to state. There are still likely to be conflicting state consumer laws after Dodd-Frank, but because of the CFPB, the economic rationale for preemptions these laws will not be as strong as in the past. Furthermore, as more fully developed below, section 1041(a) seems to be limited to the consumer protection laws transferred to the CFPB and the rules based on them; state laws that are inconsistent with the NBA and the Home Owners Loan Act ("HOLA") may still be preempted, though Dodd-Frank makes it harder for federal regulators to do so.\textsuperscript{123}

Another potential objection to the argument developed here is that even if the CFPB helps resolve efficiency problems created by differing state consumer protection laws, the CFPB may create new efficiency problems.\textsuperscript{124} For example, the Bureau’s efforts to protect consumers from unfair or abusive practices may result in decreased lending or limit the ability of financial companies to innovate and provide new products to consumers.\textsuperscript{125} Leaders in the banking industry have argued that the CFPB’s power to regulate “abusive” financial practices will lead to significant uncertainty, since unlike the terms “unfair” and “deceptive,” the term “abusive” does not have an established legal meaning.\textsuperscript{126} Furthermore, it might be argued that because the CFPB is exclusively focused on consumer protection, it may adopt regulations or take enforcement actions without any concern for the safety and soundness of the depository institutions it regulates.\textsuperscript{127} The CFPB could end up harming these institutions, and


\textsuperscript{125} See Cheyenne Hopkins, \textit{‘Chilling Effect’ of ‘Abusive’ in Dodd-Frank}, AM. BANKER, Nov. 23, 2010, at 1, 1.

\textsuperscript{126} \textit{Id.}

\textsuperscript{127} For example, the chairman of the FDIC, Sheila Bair, argued that separating consumer financial protection regulation from safety and soundness regulation would
in turn harm consumers.\textsuperscript{128} So, the charge is that the CFPB has merely shifted the problem in the preemption dilemma: instead of inefficiency stemming from inconsistent state regulation, the Bureau itself could harm consumers by limiting the ability of financial companies to innovate and lend. By resolving one dilemma, the Bureau may create another.

There are several responses to these concerns. First, as already noted, the CFPB may not declare a financial act or practice "unfair, deceptive, or abusive" if the injury to consumers is "outweighed by countervailing benefits to consumers or to competition."\textsuperscript{129} Thus, the CFPB must carefully balance the benefit to consumers from its rulemaking with the potential costs. Second, before adopting any new rules, the CFPB must first consult with the other federal financial regulators during the comment phase.\textsuperscript{130} If one of these regulators objects to a rule that the CFPB chooses to adopt, the CFPB must include the objection and the Bureau's response in its notice to the public.\textsuperscript{131} This will allow agencies like the OCC to have some influence over the CFPB's rulemaking decisions and force the Bureau to publicly argue that its rules will not reduce lending, stifle innovation, harm the soundness of banks, or increase the costs of financial products and services. A third response, and perhaps the strongest, is that Dodd-Frank constrains the CFPB through the newly created Financial Stability Oversight Council ("FSOC").\textsuperscript{132} The FSOC's voting members include the secretary of the treasury, who acts as chair, and federal financial regulators (including the director of the CFPB).\textsuperscript{133} The FSOC is responsible for "identifying threats to the financial stability of the United States; promoting market discipline; and responding to emerging risks to the stability of the United States financial system."\textsuperscript{134} The FSOC has the power to set aside or stay the adoption of a rule by the CFPB if it believes the rule "would put the safety and soundness of the United States banking

\textsuperscript{129} See id.
system or the stability of the financial system of the United States at risk.\textsuperscript{135} Upon the request of any member of the FSOC, and if two-thirds of its members agree, the FSOC may stay the adoption of one of the CFPB’s rules for a maximum of ninety days.\textsuperscript{136} Further, the FSOC may set aside one of the CFPB’s rules if two-thirds of its members vote to do so.\textsuperscript{137}

The power that the FSOC will have to stay or set aside the CFPB’s regulations raises the concern that the preemption dilemma may reappear in the same form. If the FSOC may veto the CFPB whenever it finds that its regulations or enforcements pose a threat to the economy, the CFPB may turn out to be ineffective in protecting consumers. This may lead states to adopt tougher consumer protection regulations than the federal regulators, once again presenting the dilemma of whether the federal government should preempt these state laws. Furthermore, there is always the possibility of regulatory “capture,” where an agency becomes subservient to the interests of the industry it is attempting to regulate.\textsuperscript{138} An obvious way that the CFPB could fall to regulatory capture would be if the director of the CFPB is more interested in protecting the financial industry than consumers.\textsuperscript{139} Other means of capture could involve the financial industry having greater access to senior staff in the CFPB than consumers or their advocates and thereby tilting policymaking decisions by the agency in the direction of the industry’s interests and away from the interests of consumers.\textsuperscript{140} If the FSOC or regulatory capture undermines the CFPB’s ability to protect consumers, states may feel the need to pass their own consumer protection laws again, and the issue of preemption returns.

In response to these concerns, the two-thirds majority requirement for the FSOC to set aside one of the CFPB’s regulations is likely to be a high bar to meet. Since there are ten voting members on the FSOC,\textsuperscript{141} and the director of the CFPB is a member, the

\begin{itemize}
\item \textsuperscript{135} § 1023(a), 124 Stat. at 1985 (codified at 12 U.S.C.A. § 5513).
\item \textsuperscript{136} § 1023(c), 124 Stat. at 1985–86 (codified at 12 U.S.C.A. § 5513).
\item \textsuperscript{137} See id. Setting aside a CFPB rule makes it unenforceable. See id.
\item \textsuperscript{138} See Rachel E. Barkow, Insulating Agencies: Avoiding Capture Through Institutional Design, 89 Tex. L. Rev. 15, 21 n.23 (2010) (defining “capture” as “responsiveness to the desires of the industry or groups being regulated”).
\item \textsuperscript{139} One well-known means of capture, called the “revolving-door” phenomenon, occurs when the head of an agency is influenced by the potential for future employment in the industry and, as a result, regulates that industry lightly. See id. at 23.
\item \textsuperscript{140} See id. at 22 (“Industry groups are . . . better positioned to monitor agencies closely and to challenge any and all agency decisions that will negatively affect them.”).
\item \textsuperscript{141} § 111, 124 Stat. at 1392 (codified at 12 U.S.C.A. § 5321).
\end{itemize}
director would need to persuade just three other members in order to
defeat any attempt to set aside one of the Bureau’s regulations. Regulatory capture is likely the most serious threat to the potential of the CFPB to be an effective agency, but there are aspects of the agency’s design which could prevent this result. First, the director is appointed by the president and confirmed by the Senate to a five-year term and may only be removed from office by the president for “inefficiency, neglect of duty, or malfeasance in office.”142 This provides the director with a degree of independence from any potential political pressure from a president who may disagree with the policy choices of the CFPB.143 At the same time, the funding mechanism for the CFPB provides it with significant independence from the political process in Congress. The Bureau is not funded through the regular appropriation process, but rather gets its funding through an assessment on the FRS’s annual total operating expenses.144 As a result, Dodd-Frank takes steps to insulate the CFPB from political pressure from both Congress and the president.145 Of course, this could cut both ways: the Bureau could ignore Congress’s wishes to be more aggressive on the consumer protection front, or it could ignore Congress’s wishes for it to be less aggressive. A lot depends, therefore, on the staffing of the Bureau, and most especially, who serves as director.

The early signs suggest that those staffing the CFPB will fight against agency capture. On September 17, 2010, President Obama appointed Professor Elizabeth Warren to help Treasury Secretary Timothy Geithner establish the Bureau.146 Because of political challenges, President Obama did not nominate Warren to become the director of the CFPB.147 Nevertheless, Warren’s role has provided her with the opportunity to create a strong Bureau that could resist attempts of the financial industry or the Bureau’s ideological opponents to weaken it.148 Although Warren was appointed on a

143. See Barkow, supra note 138, at 28 (“Empirical studies on when Congress opts for good-cause provisions support the view that this design feature seems largely aimed at stopping presidential pressure in particular and not necessarily at preventing interest group or partisan influence in general.”).
144. See CARPENTER, supra note 91, at 5.
145. See generally Barkow, supra note 138 (describing ways in which independent agencies can be designed in order to insulate them from capture and noting that for-cause removal and independent funding are two key elements of this design).
147. Id.
148. Warren is one of the strongest advocates of consumer financial protection in the
temporary basis, she has served as the de facto head of the CFPB. Warren has had wide latitude to hire staff and establish a culture at the CFPB, leaving an imprint on the Bureau which will likely last long after she leaves. In fact, within the first few months of her tenure, Warren had already hired about 100 high-level staffers to assist with setting up the Bureau.

In spite of these reasons for optimism that the CFPB will be able to fulfill its mission, capture remains a serious threat: considering the lobbying power of the financial industry, it will likely be aggressive in its attempt to capture the CFPB. It would be naive to suppose that simply because an agency has had strong leadership early on, and has several design features built into it which make it less likely to be captured, that it is therefore immune to capture. Fortunately, Dodd-Frank provides an important safeguard for consumers in case the CFPB turns out to be ineffective. That safeguard is the increased power that Dodd-Frank gives the states. In fact, this element of the law may help protect the CFPB from capture, as more fully explained below, since Dodd-Frank allows the states to serve as a very important check on the federal government's role in consumer financial protection. First, Dodd-Frank weakens the ability of federal regulators to preempt state consumer financial protection laws, thus strengthening the states' power to pass such laws. Second, states...
have new powers under Dodd-Frank to enforce federal law and to influence federal consumer protection regulation. The next Part discusses both of these features of the legislation and argues that Dodd-Frank has created a structure of dynamic federalism in consumer financial protection which goes further in resolving the preemption dilemma than the CFPB is capable of on its own.

IV. THE WEAKENING OF PREEMPTION AND THE RISE OF DYNAMIC FEDERALISM IN CONSUMER FINANCIAL PROTECTION

A. Enhanced Consumer Financial Protection Authority for States

The first thing to note about Dodd-Frank's preemption provisions is that they only apply to "state consumer financial laws," which are state laws that "directly and specifically regulat[e] the manner, content, or terms and conditions of any financial transaction . . . or any account related thereto, with respect to a consumer." This provision means that the preemption provisions in Dodd-Frank do not apply to basic contract laws or unfair and deceptive acts or practices laws, which have traditionally been excluded from federal preemption. Another point is that the changes Dodd-Frank makes to the preemption standards of the NBA and the HOLA do not go into effect until the "designated transfer date" on July 21, 2011. However, only financial transactions made prior to the date that Dodd-Frank was enacted (July 20, 2010) will be grandfathered in; thus, the old preemption standard will apply to these transactions. A final preliminary point is that, as discussed in the last Part, section 1041(a)(2) provides that "a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title." The preemption standards courts must follow which make preemption more difficult. See § 1044(a), 124 Stat. at 2014–17 (codified at 12 U.S.C.A. § 25b); § 1046(a), 124 Stat. at 2017–18 (codified at 12 U.S.C.A. § 1465). 154. See, e.g., § 1041(c), 124 Stat. at 2011–12 (codified at 12 U.S.C.A. § 5551). 155. § 1044(a), 124 Stat. at 2014–17 (codified at 12 U.S.C.A. § 25b). 156. LAUREN SAUNDERS, NAT'L CONSUMER LAW CTR., THE ROLE OF THE STATES UNDER THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010, at 7 (2010), http://www.nclc.org/images/pdf/legislation/dodd-frank-role-of-the-states.pdf. 157. § 1048, 124 Stat. at 2018 (codified at 12 U.S.C.A. § 5582). 158. § 1043, 124 Stat. at 2014 (codified at 12 U.S.C.A. § 5553). 159. § 1041(a)(2), 124 Stat. at 2011 (codified at 12 U.S.C.A. § 5551).
relating to the NBA and the HOLA, discussed below, are seemingly distinct from any effect on preemption contained in section 1041(a)(2). But for all of the federal consumer laws to be enforced by the CFPB, and the rules that the CFPB promulgates based on these laws, section 1041(a)(2) seems to insulate from preemption those state laws that are more protective of consumers than comparable federal laws or regulations.

As for the preemption of state consumer financial laws by the NBA or the HOLA, Dodd-Frank makes several amendments to these federal statutes and sets out a multi-element standard of preemption. First, with respect to the NBA or regulations issued under it, a state consumer financial law is preempted if it has a "discriminatory effect on national banks," meaning the law does not impact a state bank as strongly as it would a national bank. Second, if a state consumer financial law "prevents or significantly interferes with the exercise by the national bank of its powers," then it is preempted. Here, Dodd-Frank expressly incorporates the standard of preemption from Barnett Bank. Third, a state consumer financial law is preempted if a federal law contains a provision that explicitly preempts that state law. With respect to thrifts, Dodd-Frank eliminates the OTS and transfers its powers to the Federal Reserve and the OCC. The law's amendment to HOLA replaces the OTS's field preemption standard with the standard that it applies to state laws regulating national banks, so that in both cases the conflict preemption standard of Barnett Bank applies.

Dodd-Frank significantly weakens the standard of preemption articulated by the OCC in its 2004 rule and the standard that the OTS had applied to national thrifts. First, Dodd-Frank completely eliminates the OCC's language that state laws would be preempted if they "obstruct, impair, or condition" a national bank in exercising its

160. The preemption provisions in Dodd-Frank, including sections 1041(a)(2), 1044, and 1046, are somewhat unclear and courts will undoubtedly spend a lot of time studying them to determine Congress's intent. However, based on the language of the provisions and their separate locations in the text of Dodd-Frank, a plausible interpretation is that section 1041(a)(2) exempts state consumer protection laws from preemption by federal consumer protection laws while sections 1044 and 1046 set a different preemption standard based on the NBA and the HOLA.


162. Id.


164. Id.


powers. Instead of following this formulation, Dodd-Frank explicitly and repeatedly uses the *Barnett Bank* language, requiring a state law to “prevent or significantly interfere with the exercise by the national bank of its powers.” This language is notably different from the OCC’s 2004 rule: Dodd-Frank makes no reference to a state law being preempted if it puts conditions on the ability of a national bank to exercise its powers, and Dodd-Frank requires significant interference, whereas the OCC’s 2004 formulation merely required obstruction or impairment. Second, these changes are not insignificant linguistic differences between the two formulations. Section 1044 provides, as a rule of construction for the preemption standard, that “[t]his title does not occupy the field in any area of State law.” This explicit rejection of field preemption is strong evidence that the preemption standard in Dodd-Frank is meant to reject the de facto field preemption in the OCC’s 2004 rule. Third, it is worth remembering that the facts of *Barnett Bank* involved a fairly straightforward matter of conflict between state and federal laws: the Florida statute stated that national banks could not sell insurance in towns of less than 5,000 people while the federal statute said that national banks could engage in this activity. So in *Barnett Bank*, a single state law was preempted because it conflicted with a federal law, and since Dodd-Frank repeatedly referenced this case in setting its preemption standard while not referring to the 2004 OCC rule even once, it is reasonable to conclude that it was favoring the conflict preemption of *Barnett Bank* over the de facto field preemption of the OCC’s rule.

In opposition to this view of the standard of preemption in Dodd-Frank, it has been argued that the law does not actually overturn the OCC’s 2004 rule because, during the legislative debate over Dodd-Frank, Senator Thomas Carper deleted a provision that would have explicitly invalidated the rule. This is not, however, conclusive evidence of Congress’s intent since there is other evidence of the legislative process that suggests the opposite conclusion. For example, Congress rejected an amendment by Representative Melissa Bean that would have required a state law to be preempted if it

169. *Id.*
170. *Id.; see supra* text accompanying notes 46–55.
“impairs or hampers” the exercise of a national bank’s powers, language that is similar to the “obstruct, impair, or condition” language of the OCC’s 2004 rule. Thus, the legislative history does not help those who would argue that Congress meant to keep the OCC’s 2004 rule intact in Dodd-Frank.

Dodd-Frank also provides that state consumer financial laws may “apply to a subsidiary or affiliate of a national bank . . . to the same extent that the State consumer financial law applies to any person, corporation, or other entity subject to such State law.” As a result of this provision, states may regulate the operating subsidiaries of national banks in the same way that they would regulate any other business in the state. Operating subsidiaries will no longer be protected by the federal standard of preemption applied to national banks.

In addition to changes to the standard of preemption and its applicability to operating subsidiaries, Dodd-Frank makes major changes to the procedures that the OCC and the courts must now use in order to preempt state financial laws. For example, the law requires that when the OCC preempts a law, it must do so on a “case-by-case basis.” This requirement further shows how Dodd-Frank reverses the OCC’s 2004 rule, which carved out large areas of state lending laws that could be applied to national banks and held that they would be preempted. By contrast, Dodd-Frank directs the OCC to determine that a specific state consumer financial law, and those laws of other states with “substantively equivalent terms,” ought to be preempted. The ability of the OCC to preempt other state laws with “substantively equivalent terms” is constrained by the requirement that the OCC must consult with the CFPB and take its

173. See Saunders, supra note 156, at 6; Brady Dennis, House Steps Closer to Passing Financial Regulation Overhaul, WASH. POST, Dec. 11, 2009, at A22. In fact, the preemption language that was ultimately adopted was seen by some legislators as a compromise between those who wanted to exempt states from being preempted when they passed strong consumer protection laws and those who wanted a much stronger preemption standard. See Dennis, supra.


175. See id.

176. Observers believe that, because of this provision, national banks are likely to “roll up” their operating subsidiaries so that they are part of the national bank and are therefore protected by preemption. See Kate Berry, What to Do with Home Loan Units, AM. BANKER, Aug. 23, 2010, at 1, 1.


178. See 12 C.F.R. § 34.4 (2010).

views into consideration. In addition to requiring the OCC to consult with the CFPB before issuing its preemption determinations, Dodd-Frank also requires the OCC to provide “substantial evidence” justifying that preemption of a state consumer financial law follows the standard set out in Barnett Bank.

Another procedural change made by Dodd-Frank is the standard of judicial review it creates for the OCC’s preemption determinations. When courts review these determinations, they must take into account “the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision.” This standard of review is in contrast to the deferential standard toward administrative agencies taken by the courts and exemplified by Chevron v. National Resources Defense Council. The Supreme Court has previously stated that courts should not be deferential to federal agencies in preemption cases, but courts have ignored this advice in the past and given the OCC Chevron-style deference, providing a “rubber stamp” to the OCC’s preemption determinations. As a result of the standard of review set out in Dodd-Frank, courts will more likely be skeptical of the OCC’s preemption decisions than they would have been before the legislation.

A final procedural change to preemption in Dodd-Frank is the emphasis on the transparency of OCC preemption decisions. First, Dodd-Frank requires the OCC to review its preemption decisions every five years after the decision is made. During the review, the OCC must notify the public and take public comments to garner feedback about the specific preemption decision. After the review is complete, the OCC must publish a notice in the Federal Register explaining why the preemption determination should continue, or why it should be rescinded. Furthermore, when the OCC completes its review, it must submit a report of the review to Congress. These

180. Id.
181. Id.
182. Id.
183. Id.
186. See Saunders, supra note 156, at 6.
188. See id.
189. See id.
190. See id.
requirements will force the OCC to publicly justify its preemption decisions in a more rigorous manner than it has in the past, and the requirements will force the OCC to consider correcting mistaken preemption decisions. Increased political and public accountability for the OCC is likely to lead it to be more careful before it preempts state laws.

All of these changes to federal preemption of state consumer financial protection laws mean that if the CFPB does not do an adequate job of protecting consumers, the states will be able to step in and pass laws that have a better chance of avoiding preemption than was the case before Dodd-Frank. But these changes to preemption are not the only way that Dodd-Frank empowers states. States have several new powers and roles in consumer financial protection as a result of Dodd-Frank.

First, states can influence whether the CFPB adopts a new rule or makes a change to an existing rule. If a majority of states pass a resolution asking the CFPB to adopt or change a rule, then Dodd-Frank requires the CFPB to issue a notice of proposed rulemaking in response to the states' request. In considering whether to finalize a proposal from the states, the CFPB must consider whether an existing law already provides stronger consumer protection, whether the benefits of the proposal would outweigh any potential costs to consumers, and whether the proposal would harm the safety and soundness of national banks. If the Bureau decides that it will not adopt a suggested new or modified rule, it must publish an explanation of its rationale in the Federal Register and provide a copy to each state that requested the new rule or modification as well as to the banking committees in Congress.

Dodd-Frank also creates a right of action for state attorneys general to enforce any regulations adopted by the CFPB. Importantly, state attorneys general may initiate civil actions against national banks and thrifts in order to enforce the Bureau's regulations. Before taking any action against a financial institution to enforce CFPB regulations, state attorneys general must inform the Bureau.

192. § 1041(c)(1), 124 Stat. at 2011.
By creating the CFPB, weakening federal preemption, and extending new powers to states, Dodd-Frank will help resolve the preemption dilemma. The combination of these elements has created a structure of dynamic federalism in the field of consumer financial protection. The concept of dynamic federalism has been discussed recently in the context of both environmental law and securities regulation, and as the implementation of Dodd-Frank proceeds, it is likely that there will be increased discussion of dynamic federalism in the context of consumer financial protection.

B. How Dynamic Federalism Helps Resolve the Preemption Dilemma

Erwin Chemerinsky has challenged the traditional conception of federalism, which focuses on protecting state sovereignty from federal interference. For Chemerinsky, “federalism should be re-conceptualized as being about empowering government at all levels, rather than limiting power. The genius of having multiple levels of government is there are several different actors to advance rights and liberties.” Chemerinsky has argued that the Supreme Court’s increasing willingness to preempt state laws undermines the values of federalism. These values include greater democratic decision making since local and state power is closer to the people; the opportunity for states to “serve as laboratories for experimentation” in order to determine which laws work and which do not; and the greater protection of liberty that multiple levels of government offer by serving as checks on each other. Therefore, based on concerns about federalism, Chemerinsky proposes a very limited use of preemption, under which only express and conflict preemption are appropriate, and the latter should be used only where state and

198. See, e.g., Engel, supra note 12, at 170–73 (discussing dynamic federalism in the context of environmental law); Jones, supra note 12, at 121–26 (discussing dynamic federalism in the context of securities enforcement).

199. This discussion has already begun, with scholars noting how increasing state power in consumer financial protection can play a key role in providing a check on federal financial regulators, and thereby help insulate these regulators from capture. See Barkow, supra note 138, at 53–55.


201. Chemerinsky, supra note 14, at 1315.

202. See id. at 1326 (“Preempting state laws limits the ability of states to make choices that are responsive to their residents’ desires, to experiment, and to advance liberty and freedom within their boundaries. Simply put, a broad vision of inferred preemption invalidates beneficial state laws.”).

203. See id. at 1324–25.
federal laws are "mutually exclusive." According to this view of federalism, the emphasis should not only be about protecting state sovereignty; it is also important that the federal government is active and empowered. Chemerinsky argues that "empowering each level of government" is particularly important in light of the challenges of twenty-first century governance.

Other scholars have built on these ideas and have defended dynamic federalism, encouraging a reassessment of the proper balance between state and federal regulatory authority. As one scholar has explained this concept, "Dynamic federalism ... calls for a passive approach on the part of the courts, leaving the states to their own devices in terms of fending off attempts by the federal government to defeat state regulation." This view of the proper relationship between federal and state regulatory authority is opposed to a static conception, where state or federal governments play an exclusive role in regulation. The view that the courts should take a "passive" approach in the balance of federal and state power encourages the political branches of our government to be accountable for preemption. Requiring preemption only when Congress's intent is unambiguous, as Chemerinsky proposes, encourages greater political accountability for preemption decisions, rather than leaving these decisions to unelected members of the judiciary and the federal bureaucracy.

There are other features and benefits of dynamic federalism. Renee M. Jones has described the hallmarks of dynamic federalism, which she terms "vertical competition" and "regulatory dualism," as involving regulatory competition and cooperation between different levels of government. The benefits of dynamic federalism include protecting federal and state agencies from capture, maximizing scarce government resources, and improving the responsiveness of government.

Dodd-Frank is a good example of "empowering government at all levels" and promoting competition, cooperation, and overlapping authority between state and federal consumer protection authorities.

204. See id. at 1329–30.
205. See Chemerinsky, supra note 200, at 1220.
206. See Engel, supra note 12, at 176.
207. Id. (citation omitted).
208. See Chemerinsky, supra note 14, at 1329.
209. See id. at 1329–30.
211. Id. at 124–26.
First, Dodd-Frank creates the CFPB and grants it significant power to focus primarily on consumer financial protection. This represents empowerment of government at the federal level. Second, by limiting the ability of federal regulators to preempt state laws and by providing state attorneys general with new powers of enforcement of federal consumer protection laws, the states have been given overlapping authority with the CFPB. Third, there have been early signs of cooperation at the federal and state level: in January of 2011, a memorandum of understanding ("MOU") was reached between the CFPB and the Conference of State Bank Supervisors to "promote consistent examination procedures and effective enforcement of state and federal consumer laws and to minimize regulatory burden and efficiently deploy supervisory resources." This MOU indicates that one of the benefits of dynamic federalism—maximization of scarce government resources—promises to be one of the benefits of the regulatory structure created by Dodd-Frank. The MOU also emphasizes another point that brings this discussion back to the preemption dilemma: state and federal cooperation to "minimize regulatory burden." One of the challenges going forward for both state and federal regulators will be to balance the values of economic efficiency with the need for greater consumer financial protection.

The framework of dynamic federalism created by Dodd-Frank has the potential to make significant progress in resolving the preemption dilemma because of its encouragement of both cooperation and competition between state and federal regulators. By granting the CFPB significant powers as a federal consumer protection agency, Dodd-Frank provides it with the power to set a high federal floor of consumer protection, thereby reducing the need for state regulation. Because the CFPB will be adopting nationwide regulations, this will promote consistency and efficiency in the financial industry. Moreover, although the states have greater flexibility in passing their own consumer protection laws and avoiding preemption, Dodd-Frank still enables the OCC to preempt those state laws that clearly conflict with the NBA or the HOLA. Thus,

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213. Id.
there are some constraints built into Dodd-Frank which help create a balance between strong consumer protection and efficiency without the need to give the OCC the heavy-handed preemption power that it has claimed for itself in the past.

At the same time, Dodd-Frank helps meet the other side of the preemption debate that argues for stronger consumer protections: states' increased power gives them leverage in serving as a check on the CFPB and other federal agencies, allowing them to pass tougher consumer protections if the CFPB does not act effectively. If the CFPB fails to adopt strong regulations as a result of capture or because the FSOC undermines needed regulations, states may choose to pass resolutions requesting the CFPB to adopt a new rule. Some states could also threaten to pass their own consumer protection laws in order to fill a perceived gap in regulation. As a result of this pressure from the states, the Bureau may be convinced that there is a need for national regulation in order to promote greater uniformity across the nation while also providing greater protection for consumers. Alternatively, the requirement that the CFPB must explain why it is choosing not to adopt a rule may persuade states that regulation would do more harm than good. In either case, it is possible that the states will have no need for passing their own consumer protection laws in this area, and the possibility of preemption would be avoided. This is one way in which cooperation between the states and the CFPB helps ease the preemption dilemma.

The power of states to enforce the CFPB's regulations illustrates another way in which the preemption dilemma will be less serious after Dodd-Frank. Since the states will now have a much more significant role in consumer protection, they will be able to effectively compete with the CFPB. If the CFPB fails to enforce certain regulations that it has adopted, states will then be able to sue national banks or national thrifts in order to enforce the CFPB's own regulations. Since states will be able to enforce a federal regulator's own rules, they may not need to pass their own consumer financial protection laws as often as in the past in order to engage in their own enforcement. By avoiding state legislation in this way, federal regulators will be less prone to preempt state laws, and the preemption dilemma will arise less frequently. In addition to potentially reducing the need for preemption, the greater

217. See id.
enforcement power given to the states may help prod the CFPB into action and thereby help reduce the likelihood of capture and inertia at the Bureau. By competing with the CFPB in this way, the states will serve as a check on the agency and help ensure that it is active in enforcing its own regulations.

In sum, Dodd-Frank has pushed consumer financial protection firmly in the direction of dynamic federalism, and this shift will help resolve the preemption dilemma. This development represents a significant change from the static regulatory structure of the past decade where the OCC and the OTS prevented states from exercising regulatory power, particularly in the area of predatory lending. The states are now closer to being coequal regulators with the federal government in the realm of consumer financial products and services. By strengthening consumer financial protection authority at the state and federal levels, the need for preemption—and any dilemma that follows—should decline.

CONCLUSION

This Recent Development has presented a way to understand Dodd-Frank as providing a new framework between state and federal consumer protection authority. Dodd-Frank creates a structure of "dynamic federalism" in consumer financial protection regulation: it creates a new federal agency charged with protecting consumers and adopting nationwide regulation, and it gives states more powers to protect their own citizens than existed before the legislation. The new relationship that Dodd-Frank creates between states and the federal government can be seen most clearly in the ways that it helps resolve the preemption dilemma. This dilemma arises because federal preemption of state consumer financial laws does provide consumers with economic benefits, but at the same time, preemption may also hurt consumers. Both sides of the debate about federal preemption that has occurred over the past decade have had an element of truth in their arguments. However, because of Dodd-Frank's changes to

219. This point is not speculative. Other areas of regulation, in which state regulators spurred the federal government into taking action, thus resulting in effective cooperation between state and federal agencies, illustrate how a framework for dynamic federalism can develop. This has happened, for instance, in the case of securities regulation. Eliot Spitzer, then-attorney general of New York, investigated and exposed analyst conflicts, and the SEC later joined him in his actions. This collaboration allowed state and federal government to share resources and resulted in a global settlement of $1.4 billion with major Wall Street firms. See Jones, supra note 12, at 118–19. For a detailed account chronicling Spitzer's investigation of analyst conflicts, see generally John Cassidy, The Investigation: How Eliot Spitzer Humbled Wall Street, NEW YORKER, Apr. 7, 2003, at 54.
preemption, the emergence of the CFPB, and the new powers that Dodd-Frank provides the states, this debate is now likely to become much less pronounced.

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