LJN LAW JOURNAL NEWSLETTERS

NEW YORK REAL ESTATE LAW REPORTER ®

An ALM Publication

Volume 31, Number 9 • July 2015

Does the CFPB's New Integrated Disclosure Rule Preempt New York State Law?

By Eric B. Epstein and Daniel W. Beebe

The Consumer Financial Protection Bureau's (CFPB) new "Integrated Disclosure Rule" — currently scheduled to take effect on Oct. 1, 2015 — redesigns the disclosures that are provided under the Federal Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) in connection with certain residential mortgage transactions.

This reform is a product of the Dodd-Frank Act of 2010, which directed the CFPB to "simplify the technical nature of the disclosures" by "utilizing readily understandable language." *See* 12 U.S.C. § 2603(a); 15 U.S.C. § 1604(b). The revised disclosures must use "plain language comprehensible to consumers" and "a clear format and design" to "succinctly explain[] the information that must be communicated" to the borrower. *See* 12 U.S.C. § 5532(b)(2). The new disclosures must be "validated through consumer testing," and must be informed by "available evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services." *See* 12 U.S.C. §§ 5532(b)(3), (c).

Eric B. Epstein is a partner at Dorsey & Whitney LLP and an adjunct instructor at the Columbia University School of Law. **Daniel W. Beebe** is an associate at the firm.

Background

Drawing upon current research in the field of consumer psychology, the CFPB concluded that balancing the competing concerns of under-disclosure and "information overload" is essential. *See* Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 79730, 79742 (Dec. 31, 2013). According to the CFPB's findings, "information overload" occurs when "the volume or complexity of information detracts from the consumer decision-making processes." *Id*. The CFPB thus set out to "reduce the number of pages of forms" and in other respects simplify the disclosures. *See* 78 Fed. Reg. 79730, 80080. The CFPB focused on four separate disclosures that were required under existing federal law — the "early" TILA disclosure, the Good Faith Estimate, the final TILA disclosure, and the HUD-1 — and combined them into two forms: a "Loan Estimate" and a "Closing Disclosure."

To validate the effectiveness of the revised forms, the CFPB conducted a variety of consumer tests, among which was "a large-scale quantitative validation study … with 858 consumers." *See* 78 Fed. Reg. 79730. Participants ranged from individuals with relatively high levels of financial literacy to those who had never purchased a home, had never worked in the mortgage industry, were not college educated, and/or had household income under $35,000. *See* Know Before You Owe: Quantitative Study of the Current and Integrated TILA-RESPA Disclosures, Kleimann Communication Group, Inc., Nov. 20, 2013, at 32-35 (http://1.usa.gov/1TuwLRu). The CFPB found that "consumers could comprehend the proposed disclosures and explain a rationale for their choices," and "could compare the information on two disclosures, choose a loan, and use the disclosures to compare initial and final loan terms and costs." *See id*. Consumers also could "make sophisticated trade-offs" among different loan options. *See* Know Before You Owe: Evolution of the Integrated TILA-RESPA Disclosures, Kleimann Communication Group, Inc., Jul. 9, 2012, at 90 (http://1.usa.gov/1CdTSVC).

A Challenging Question

The Integrated Disclosure Rule raises a challenging question of preemption. In the past, New York State law has clashed with federal law in regard to the adequacy of consumer disclosures when consumers, invoking New York common law rules and consumer-protection statutes, have argued that federally compliant disclosures are inadequate under state law. The Supremacy Clause potentially can trump such claims. However, in any given case the issue will turn on such factors as the purpose and nature of the federal statutory and regulatory regime, the preemption standard (if any) contained in the federal statute and associated regulations, and the consumer-plaintiff's theory of liability under New York law. *See, e.g., Riegel v. Medtronic, Inc.*, 552 U.S. 312, 325 (2008) (holding that a New York common law claim regarding the design, labeling and manufacture of a catheter device was preempted by federal law, as "[s]tate tort law that requires a manufacturer's catheters to be safer, but hence less effective, than the model the FDA has approved disrupts the federal scheme no less than state regulatory law to the same effect."); *People ex rel. Spitzer v. Applied Card Sys., Inc.*, 11 N.Y.3d 105, 114 (2008) (rejecting the defendant's argument that the Attorney General's claims were preempted by TILA, as the "the claims do not relate to the disclosure of credit information, but rather to affirmative deception.").

Will the Integrated Disclosure Rule preempt claims of that nature as they relate to residential mortgage disclosures? After all, the CFPB has determined that the revised TILA and RESPA disclosures will provide precisely the right amount of information — not too little, not too much — to a borrower. Should a court entertain an argument that such disclosures are insufficient under New York law?

Analysis

This issue is especially complex because it comes at a time of transition in the federal residential mortgage disclosure rules and the provisions governing the preemptive effect of these rules. First, although the new Integrated Disclosure Rule has put these disclosures on a new empirical footing, the federal statutes and regulations governing the preemption of state law in this area have not been substantially updated. As before Dodd Frank, state laws that are "inconsistent" with TILA or RESPA are potentially preempted (*see* 12 U.S.C. § 2616; 15 U.S.C. § 1610(a)), but an exception is made for state laws that give "greater protection to the consumer" (*see* 12 U.S.C. § 2616; Regulation X, 57 Fed. Reg. 49600-01 (Nov. 2, 1992)). In particular, state laws that "call for the disclosure of items of information not covered by the Federal law" or "require more detailed disclosures" are not necessarily preempted. *See* 12 C.F.R. Pt. 226, Supp. I, Subpt. D § 226.28(a)(3). Congress has not yet clarified how this language meshes with the science of consumer psychology that underpins the Integrated Disclosure Rule. For example, what if a well-intentioned effort by a state to offer "greater protection to the consumer" by requiring more voluminous mortgage disclosures would create, in actuality, the opposite effect by causing information overload?

Second, in terms of analogous consumer protection regimes that to some extent preempt state law, what model is the Integrated Disclosure Rule seeking to emulate? For instance, the U.S. Supreme Court has held that the FDA's approval of a drug label did not necessarily preempt a state-law failure-to-warn claim, because, even with FDA approval, "the manufacturer bears responsibility for the content of its label at all times." *See Wyeth v. Levine*, 555 U.S. 555, 571 (2009). By contrast, as mentioned above, the Supreme Court also has held that a New York tort-law claim regarding the allegedly deficient labeling of a medical device was preempted, for "while the common-law remedy is limited to damages, a liability award 'can be, indeed is designed to be, a potent method of governing conduct and controlling policy.'" *See Riegel*, 552 U.S. at 324.

Third, in addition to requiring the reform of residential mortgage disclosures, the Dodd-Frank Act made certain changes to the preemption standards associated with the National Bank Act (NBA), which applies to nationally chartered banks, and the Home Owners' Loan Act (HOLA), which governs thrifts. Pre-Dodd Frank, due to the expansive preemption rules contained in the NBA, HOLA and related agency regulations, the preemptive effect of RESPA or TILA was in many cases a moot point. An as-yet-unsettled question is how the NBA and HOLA will interact with TILA and RESPA going forward, post-Dodd Frank, in regard to the potential preemption of New York law.

Conclusion

In this context of considerable uncertainty, it is perhaps useful to refer to the preemption determinations that the CFPB has made to date. In 2013, the CFPB addressed the question of whether certain provisions of the Electronic Fund Transfer Act and Regulation E preempted the laws of Maine and Tennessee regarding unclaimed gift cards. Although the substance of that question did not concern mortgage disclosures, the relevant preemption standard was similar to that at issue here in that it allowed states to provide greater protection to the consumer. In its decision, the CFPB construed that standard to mean that a state law could survive if it resulted in demonstrable "consumer benefit." *See* Electronic Fund Transfers; Determination of Effect on State Laws (Maine and Tennessee), 78 Fed. Reg. 24386, 24391. Here, the Integrated Disclosure Law represents the CFPB's attempt to use the science of consumer psychology to provide maximum benefit to the consumer. Thus, to the extent a consumer seeks to use New York law to challenge a disclosure that is compliant with that rule, such a claim likely will not survive a preemption analysis.

—❖—