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WHAT YOUR LENDER AND MORTGAGE BROKER DIDN'T TELL YOU: A CALL FOR DISCLOSURE OF LOSS OF THE SECTION 580b ANTI-DEFICIENCY PROTECTION UPON REFINANCING

*George W. Kuney**

INTRODUCTION

California Code of Civil Procedure section 580b protects a California homeowner from a deficiency judgment when the homeowner's purchase-money lender forecloses upon the home after default. In other words, if the price the lender realized at the foreclosure sale is less than the outstanding amount of the debt, the homeowner will not be liable for the deficiency.¹ Section 580b was enacted to discourage the purchase money lenders from over-valuing real property by requiring a lender to look solely to the collateral's value for recovery in the event of foreclosure, and to prevent the aggravation of an economic downturn caused by increased debt exposure to

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1. Cal. Code Civ. Proc. § 580b (West 1993 & Supp. 2007).

homeowners during a depression.² Section 580b's protection cannot be contractually waived by the borrower.³

The protection of section 580b only applies to purchase money mortgages.⁴ A lender may recover a deficiency judgment against a borrower who refinances an existing mortgage and later defaults, and a lender may recover a deficiency judgment with respect to any other non-purchase money loan, such as a home equity line of credit.⁵ If the protection provided by section 580b is not disclosed, borrowers often remain unaware of the anti-deficiency protection and that it is lost upon refinance. These borrowers risk losing protections which may prove substantial if the housing market slumps. Instead of having the right to walk away from the home, the refinancing borrower is liable for the full amount of the debt, including contract interest and fees and, if the debt is reduced to judgment, post-judgment interest at the rate of ten percent.⁶

The California Civil Code requires an initial disclosure of the anti-deficiency protection to purchase-money mortgage borrowers, but it does not require disclosure of the potential loss of that protection during refinancing.⁷ Moreover, lenders who are subject to the Federal Truth in Lending Act or the Homeowners Equity Protection Act required to make the disclosures required by the Civil Code⁸ because federal law preempts state law in this area. California is thus unable to enforce even its minimal state law requiring disclosure of anti-deficiency protection to purchase-money borrowers due to the pervasive scheme of federal lending and banking regulations. For the same reason, California cannot effectively expand this disclosure obligation to include disclosure of the loss of the protection upon refinance. The absence of an enforceable duty to disclose anti-deficiency protection or the conditions of its loss means that many borrowers — especially unsophisticated borrowers without legal representation (e.g., typical homeowners) — are vulnerable to losing the protection of section 580b without notice or recourse or even knowing that it existed in the first place.

This article urges that these disclosure omissions be cured. The recent slump in housing prices, along with the growth of sub-prime purchase money and refinance transactions with low or no equity requirements,⁹

2. *Roseleaf Corp. v. Chierighino*, 59 Cal.2d 35, 42 (Cal. 1963).

3. *Cadle Co. II v. Harvey*, 83 Cal. App. 4th 927, 932 (Cal. Ct. App. 2000); *Palm v. Schilling*, 199 Cal. App. 3d 63, 73 (Cal. Ct. App. 1988).

4. *Jones v. Wagner*, 90 Cal.App.4th 466, 480 (Cal. Ct. App. 2001).

5. *Goodyear v. Mack*, 159 Cal. App. 3d 654, 659 (Cal. Ct. App. 1984).

6. Cal. Code Civ. Proc. § 685.010(a) (West 1993).

7. Cal. Civ. Code § 2956, 2963 (West 1993).

8. Cal. Civ. Code § 2958 (West 1993).

9. See generally Mark Whitehouse & Mike Spector, *Subprime Fallout May Not Infect Broader Market*, WALL ST. J., Mar. 12, 2007, at A2; Nick Timiraos, *Hot Topic: The Subprime Market's Rough*

underscores the importance to consumers of knowing their rights under section 580b and that they will lose them when entering into a refinancing transaction. Disclosure of section 580b protection in an initial purchase money financing transaction is important, but alone is not enough. Disclosure of its loss in a refinancing transaction is far more important to the borrower. Refinancing dramatically changes the risk allocation between lender and borrower of overvaluation of the collateral — the home — by shifting it overwhelmingly to the borrower. The true cost of refinancing, then, can only be known if the loss of section 580b anti-deficiency protections is factored into the equation. To be effective, this disclosure requirement should be required under federal as well as California law due to the preemptive and pervasive effect of the former on the latter.

Section I of the article discusses the disclosure requirements of the California Civil Code. Sections II and III then turn to the preemptive effect of the federal Truth in Lending Act and federal banking and lending regulations. Section IV concludes the article by asserting that a federal disclosure requirement of the section 580b protections and their loss upon refinancing and any similar protections and their loss available under applicable state law, is desirable.

I. THE DISCLOSURE REQUIREMENTS

In sections 2956 and 2963, the California Civil Code requires disclosure of Code of Civil Procedure sections 580b's protection to purchase money mortgagors before the execution of any note or security documents. Section 2963 states, in relevant part:

The disclosures required to both purchaser and vendor by this article are:

....

(i) ... A warning should also be expressed that Section 580b of the Code of Civil Procedure may limit any recovery by the vendor to the net proceeds of the sale of the security property in the event of foreclosure.¹⁰

The Civil Code does not, however, require disclosure that the protection is extinguished by refinancing the note and mortgage.

Furthermore, even the initial disclosure is not required when the

Road, WALL ST. J., Feb. 17, 2007, at A7 (Saturday Correction Appended); Ruth Simon & James R. Hagerty, *More Borrowers With Risky Loans Are Falling Behind — Subprime Mortgages Surged As Housing Market Soared; Now, Delinquencies Mount*, WALL ST. J., Dec. 5, 2006, at A1.

10. Cal. Civ. Code § 2963.

purchaser is entitled to receive a disclosure under the Truth in Lending Act (“TILA”).¹¹ Congress has legislated lending disclosure requirements through the Truth in Lending Act and its implementing regulation, Regulation Z, which regulate the disclosures lenders must make to customers and potential customers of loan products.¹² Disclosures for high-risk home loans are covered by the Homeowners’ Equity Protection Act (“HOEPA”), also implemented through Regulation Z.¹³ In addition to TILA and HOEPA, certain lenders are required to make disclosures under the Truth in Savings Act (“TISA”).¹⁴ Regulation Z requires the disclosure of specific terms within a credit transaction, such as the rate of interest and the consumer’s right of rescission.¹⁵ For home-equity plans, the lender must also disclose their acquisition of a security interest in the home and that the borrower might lose the home in the event of a default.¹⁶ However, neither TILA nor Regulation Z requires the disclosure of rights that arise under state law, like section 580b.

Regulation Z only applies to individuals or businesses that conducted at least twenty-five extensions of credit (or five, in the case of dwelling-secured transactions) in the year preceding a given transaction.¹⁷ The practical result is that a private individual who finances a small number of transactions must meet the disclosure requirements of California Civil Code section 2956, while a company in the business of extending credit thousands of times a year might not because only the federal disclosure requirements apply to them.

II. PREEMPTION ANALYSIS OF THE TRUTH IN LENDING ACT

The Supremacy Clause of the Constitution gives Congress the power to preempt state law.¹⁸ Ordinarily, there is a presumption against preemption unless there is a clearly manifested intent by Congress to preempt.¹⁹ This intent may be an express declaration of preemption, as in the case of copyright law.²⁰ The result is termed “field preemption.” Congressional legislation also preempts State law that conflicts with it, as in the case of

11. Cal Civ. Code § 2958.

12. 15 U.S.C. §§ 1601-1667f. (2000 & Supp. 2004); 12 C.F.R. §§ 226.1-226.36 (2008).

13. 15 U.S.C. § 1639(a) (2000); 12 C.F.R. § 226.32(c) (2008).

14. 12 U.S.C. §§ 4301-4313 (2000 & Supp. 2004); 12 C.F.R. §§ 230.1-230.11, §§ 707.1-707.11 (2008).

15. 12 C.F.R. § 226.14, § 226.15 (2008).

16. *Id.* § 226.5(d)(3).

17. *Id.* § 226.2(17)(i).

18. U.S. CONST. art. VI, cl. 2.

19. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654 (1995); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

20. 17 U.S.C. § 301 (2000).

TILA.²¹ This is aptly termed “conflict preemption.” Another form of preemption occurs when Congress legislates so thoroughly in a given field that, even without an express declaration, all conflicting State laws are preempted as well as any State law governing in that field.²² This is termed “implied field preemption.” In the field of banking, the Supreme Court has long and routinely held that Congress’s exercise of its preemption power is within its authority.²³ Congress and the federal agencies implementing its legislation have regulated the field of banking to the extent that the presumption against federal preemption no longer applies.²⁴

The Truth in Lending Act preempts state credit disclosure laws that are inconsistent with its requirements to the extent of the inconsistency.²⁵ TILA further states that a state law “is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law.”²⁶ In its official staff interpretations of Regulation Z, the Federal Reserve Board has said that “[g]enerally, State law requirements that call for the disclosure of items of information not covered by the Federal law, or that require more detailed disclosures, do not contradict the Federal requirements.”²⁷ Additionally, in *Black v. Financial Freedom Senior Funding Corp.*, the California Court of Appeal held that “an inconsistency or contradiction with federal law does not exist merely because the state requires disclosures *in addition* to those required by and under TILA.”²⁸

TILA does not technically preempt California Civil Code section 2963, but section 2958 acquiesces to TILA’s disclosure requirements for TILA-eligible lenders. Thus, the initial disclosures required by sections 2956 and 2963 are required only for lenders who do not qualify to make TILA disclosures — those who did not perform enough transactions within the statutory period. For lenders who perform enough loan transactions to be eligible to make TILA disclosures, the election to make disclosures under TILA relieves them of the California disclosure requirements.

Due to the deferential provisions of Civil Code section 2958, the existing disclosure requirements under California law do not reach many protected borrowers. The end result is that a borrower, particularly one without legal representation, might obtain a purchase money mortgage (protected from a deficiency judgment under California Code of Civil

21. 15 U.S.C. § 1610(a)(1) (2000).

22. *Rice*, 331 U.S. at 230 (1947).

23. *See, e.g.*, *First Nat. Bank of San Jose v. California*, 262 U.S. 366, 369-70 (1923), *McCulloch v. Maryland*, 17 U.S. 316, 404-09 (1819).

24. *United States v. Locke*, 529 U.S. 89, 108 (2000); *Barnett Bank of Marion County, N A v Nelson*, 517 U.S. 25, 33-35 (1996).

25. 12 C.F.R. § 226.28(a)(1) (2008).

26. *Id.*

27. 12 C.F.R. § 226.28(a)(3) (Supp. I. 2006).

28. 92 Cal. App. 4th 917, 936 (Cal. Ct. App. 2002) (citations omitted) (emphasis added).

Procedure section 580b), then refinance the mortgage. By so doing, they give up that protection without ever knowing that it existed, much less that it would disappear upon refinancing.²⁹ Without a federal duty to disclose the protection's existence, institutional lenders are more likely to recover deficiency judgments against previously protected consumers simply by refinancing the purchase money loans.³⁰ Without a duty to disclose the protection or its loss, a consumer in such a position is without a cause of action against such a lender, assuming of course that no affirmative, material misrepresentations were made.

New legislation is needed to require the disclosure of section 580b's protection from all lenders or else to extend the protection to cover disclosure at all refinancing transactions in addition to purchase money transactions. Because the scheme of federal banking and lending regulations preempt the enforcement of any such state legislation, it is likely that the only effective remedy to this problem is Congressional action, preferably Congressional action coupled with increased disclosure requirements at the state level.

III. PREEMPTION ANALYSIS OF FEDERAL BANKING AND LENDING REGULATIONS

The fact that TILA does not preempt the disclosure requirements of Civil Code sections 2956 and 2963 does not alleviate the risk of federal preemption by other legislation and regulations.³¹ The extent of large lending institutions' operations, along with the complex nature of mortgage securitization,³² means that several federal agencies may have regulatory authority, and thus preemptive power, with respect to the operations of a given lender.³³

29. See Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 51 (2005), for a discussion on the relationship between borrower education and sophistication with loan disclosure.

30. If the number of refinancing solicitations that the author receives is any indication, seeking to refinance out purchase-money loans is a common practice and procedure in the home lending industry. Although the loss of anti-deficiency protection may not be the goal that drives this process — more lending, more refinancing fees (points), and the ability to reset fixed-rate, below-market mortgages to market rates are more likely to be driving the phenomenon — the loss of these borrower protections are a not unhappy consequence of refinancing for the lender.

31. See, e.g., *Sylvas v. E-Trade Mortg. Corp.*, 421 F. Supp. 2d 1315, 1321 (S.D. Cal. 2006) (holding that state laws which were not preempted due to TILA's savings clause could still be preempted by the Home Owners' Loan Act).

32. See generally Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185 (2007) (discussing consumer protection in light of securitization).

33. For example, a bank may qualify as a savings institution under 12 U.S.C. § 1462 (2000), such that it could be regulated by OTS, as well as a national bank under 12 U.S.C. § 1813 (2000), such that it

Some lender categories emerge by virtue of the requirements of the Securities Exchange Commission³⁴ as well as the assignment of certain lenders to federal agencies by banking and lending legislation.³⁵ While an analysis of securitization and the nature of corporate structure in the lending industry is beyond the scope of this article, it is helpful in breaking down the preemption analysis into five broadly defined categories: (1) federally chartered savings institutions, (2) state chartered savings institutions, (3) national commercial banks, (4) subsidiaries of national commercial banks, and (5) federal credit unions.

Congress has preempted state regulation of banks, savings institutions, and credit unions, and the agencies responsible for those areas have exercised their power to varying degrees. The Office of Thrift Supervision (“OTS”) has occupied the field of lending regulation for federal savings institutions, preempting all state law regulation of federally chartered savings institutions, including regulation regarding mortgages and lending disclosures.³⁶ The Office of the Comptroller of Currency (“OCC”) has preempted regulation of national banks as well, but only preempts state law regulations that “obstruct, impair, or condition” a national bank’s ability to exercise its federally regulated powers.³⁷ The National Credit Union Administration (“NCUA”) preempts regulation of federal credit unions, except concerning “state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit.”³⁸ Currently there is no preemption by the Federal Deposit Insurance Corporation (“FDIC”), though the implementation of such regulations may be imminent.³⁹

What follows is a brief analysis of the regulations that govern lending institutions and banks with respect to the enforcement of state disclosure law and the potential for a private cause of action arising out of a lender’s non-disclosure of California Code of Civil Procedure section 580b’s anti-deficiency protection.

could also be regulated by NBA. *See, e.g.*, *Bank of Am. v. City and County of S.F.*, 309 F.3d 551, 561 (9th Cir. 2002) (holding that HOLA preempted state ordinances regulating national banks with respect to the charging of ATM fees to non-depositors because the charging of fees was a power authorized to national savings banks by OTS).

34. 15 U.S.C.S. § 78I(b)(1)(A) (2000) (requiring that institutions registered with the Securities Exchange Commission identify the nature of their business).

35. *See, e.g.*, 12 C.F.R. § 226 (App. I 2006).

36. 12 U.S.C. §§ 1461-1470 (2000, Supp. 2007), implemented by 12 C.F.R. § 560 (2008).

37. 12 C.F.R. § 7.4009 (2008).

38. *Id.* § 701.21(b)(2).

39. *Id.* § 332.17; *but see* Interstate Banking and Federal Interest Rate Authority, 70 Fed. Reg. 60019, 60019 (proposed Oct. 14, 2005) (to be codified at 12 C.F.R. pts 331 & 362).

A. PREEMPTION OF STATE REGULATION OF FEDERALLY CHARTERED SAVINGS INSTITUTIONS

Federally chartered savings institutions — thrift institutions that primarily offer home mortgage loans — are regulated expressly and exclusively by the Office of Thrift Supervision. This category includes such institutions as Countrywide Financial and IndyMac. State attempts to regulate federally chartered savings institutions have routinely been unsuccessful, and courts have held that federal laws preempt state laws that even touch upon the operations of thrifts.⁴⁰ Presumably, a cause of action arising out of a state law duty to disclose would also be preempted.

Federally chartered savings institutions are answerable to the OTS.⁴¹ In 12 C.F.R. § 560.2, the OTS has explicitly preempted a cause of action arising from state law:

(a) . . . To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or § 560.110 of this part. For purposes of this section, “state law” includes any state statute, regulation, ruling, order or judicial decision.

(b) Illustrative examples. Except as provided in § 560.110 of this part, the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:

. . . .
(9) Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents and laws requiring creditors

40. See, e.g., *Lopez v. Washington Mut. Bank*, FA, 302 F.3d 900 (9th Cir. 2002), amended by 2002 U.S. App. LEXIS 24344, at *15-17 (9th Cir. Aug. 6, 2002) (holding that state law exempting Social Security from enforcement action was preempted); see also Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting off More than They Can Chew?*, 56 AM. U. L. REV. 515 (2007) (discussing the scope of OTS’s preemption efforts).

41. 12 U.S.C. § 1464 (2000 & Supp. 2007).

to supply copies of credit reports to borrowers or applicants;

(10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages;

Subpart (c) provides that state laws that only incidentally affect the lending operations of federal savings associations or are otherwise consistent with the purposes of paragraph (a) are not preempted,⁴² including other fields of laws like tort law and commercial law, nor are state laws that further a vital state interest and have only an incidental effect on lending operations.⁴³

The California Court of Appeal has construed the Homeowners Loan Act and the regulations promulgated under it. *Washington Mutual Bank v. Superior Court* provides one illustration of the scope of the OTS's preemptive power citing an OTS explanation of how to determine whether and when preemption applies,⁴⁴ which stated, "When analyzing the status of state laws under [section] 560.2, the first step will be to determine whether the type of law in question is listed in [section 560.2] paragraph (b). If so, the analysis will end there; the law is preempted."⁴⁵

In *Washington Mutual*, the plaintiffs sued on the basis, among others, of California Code of Civil Procedure section 2948.5, which limited the lender's power to collect interest.⁴⁶ The court reasoned that since paragraph b of 12 C.F.R. § 560.2 listed interest as a category, the claim was preempted.⁴⁷ More importantly, the court held that the OTS was within its authority to regulate lending so pervasively.⁴⁸

Given that the OTS has included disclosure and mortgages in its preemption regulations, and given the deference given the agency by courts, one can conclude that HOLA and its implementing regulations would preempt enforcement of a state law requiring disclosure of protections available to a borrower. Thus, even though TILA does not preempt a law, it would still be preempted by other federal regulations.

The hurdle of field preemption created by HOLA and the OTS is extremely effective at preventing consumers from enforcing their protections available under California law. These regulations effectively shut down the power of the state to require disclosure of consumer protections from the vast majority of lenders, and allow lenders to encourage borrowers to refinance themselves out of their protections without notice that those protections will cease. These regulations beg the

42. 12 C.F.R. § 560.2(c) (2008).

43. *Id.* § 560.2(c)(6).

44. 95 Cal. App. 4th 606, 620 (Cal. Ct. App. 2002).

45. 61 Fed. Reg. 50951, 50966 (Sept. 30, 1996)

46. 95 Cal. App. 4th at 610.

47. *Id.* at 621.

48. *Id.* at 617.

question of whether the national consistency of thrifts sought by the OTS justifies placing the risk of non-disclosure on those borrowers who are most vulnerable.

B. PREEMPTION OF STATE REGULATION OF STATE CHARTERED SAVINGS INSTITUTIONS

Additionally, some state chartered savings institutions are under the protective arm of the OTS by the Alternative Mortgage Transaction Parity Act ("Parity Act"). However, the Parity Act only applies to alternative mortgages so state laws that require disclosure of borrowers' anti-deficiency protection are enforceable insofar as the protected loans are traditional mortgages.

Alternative mortgages are basically any loan secured by residential real property with an adjustable interest rate, a fixed rate with a balloon payment, or a similar variation not common to traditional fixed-rate, fixed-term transactions.⁴⁹ Traditional mortgages, generally, are any fixed rate or fixed term mortgage. The Parity Act provides state institutions the same federal protection applicable to federal institutions under the regulations promulgated by the OCC, the NCUA, and the OTS,⁵⁰ but there does not appear to be a counterpart to preempt action against state-chartered lending institutions engaging exclusively in traditional mortgage transactions.

In *Black v. Financial Freedom Senior Funding Corp.*, the California Court of Appeal held that the Parity Act preemption statute would not bar the plaintiffs' state law claims arising from a reverse mortgage transaction.⁵¹ The court found that regulations promulgated by the OTS with respect to the Parity Act⁵² were not relevant to the plaintiffs' claims, and therefore Congress may not have intended to preempt other areas of state regulation of alternative mortgages.⁵³ The court continued that the Parity Act did not manifest a clear intent to preempt all state laws governing the area, and so the court declined to find express field preemption and went on to reject implied field preemption and conflict preemption as well, since the regulations did not conflict with the state laws at issue.⁵⁴

This seems to suggest that a borrower could maintain an action against a state chartered savings institution for non-disclosure of the anti-deficiency protections required under state law when the borrower refinances a

49. 12 U.S.C. § 3802 (2000).

50. *Id.* §§ 3801-3806 (2001 & Supp. 2007).

51. 92 Cal. App. 4th 917, 933 (Cal. Ct. App. 2002).

52. 12 C.F.R. 560.220 (2008).

53. *Black*, 92 Cal. App. 4th at 930.

54. *Id.* at 931.

purchase money mortgage by taking a second traditional mortgage. However, the narrow scope of the availability of such an action, and the policy behind the Parity Act, make the possibility questionable. The Parity Act was implemented to maximize the abilities of borrowers to obtain financing.⁵⁵ Since the purpose of the Parity Act is to prevent prejudice against state lenders, an action that targets them because of a gap where national lenders are protected by HOLA could be held contrary to the intent of Congress. A court might well hold, albeit on shaky reasoning, that conflict preemption would bar such a claim.⁵⁶ Nonetheless, insofar as state lenders make alternative loans, they will be afforded the same protection from state law interference as their federally chartered counterparts.

The most significant impediment to an action against a state chartered savings association for non-disclosure of anti-deficiency protection is not federal preemption. Instead it is the absence of a duty to make that disclosure, primarily due to California Civil Code section 2958. Without the TILA option to bypass state law requirements, state chartered savings associations would be required to make at least an initial disclosure to borrowers of their protection under section 580b. In a market saturated with alternative mortgages, the preemption provided by the Parity Act affords state chartered savings institutions the same protections available to federally chartered savings institutions. However, a market shifting in favor of traditional, fixed-rate mortgages diminishes TILA exemption, and state chartered savings institutions are more likely to be subject to state law disclosure requirements. Of course, recent years have shown an expansion in non-traditional mortgages, not the other way around.

C. PREEMPTION OF STATE REGULATION OF NATIONAL COMMERCIAL BANKS

The third category of lenders is national commercial banks, whose primary business is to provide general financial services. They are distinguishable from savings institutions, whose primary business is to receive deposits and make home loans. Another difference is that national commercial banks are chartered under the OCC instead of the OTS. This category includes Bank of America, MBNA, and Wells Fargo. As mentioned earlier, HOLA protects national commercial banks from suit arising from state law regulations.⁵⁷ They are also protected by the National Bank Act ("NBA") and its enforcing agency, the OCC.⁵⁸ The OCC has not

55. 12 U.S.C. § 3801 (2000).

56. *Id.* § 3803(a).

57. *Bank of Am. v. City and County of S.F.*, 309 F.3d 551, 560-61 (9th Cir. 2002).

58. 12 U.S.C. § 21 *et seq.* (2000 & Supp. 2007).

been as aggressive as the OTS in seeking to preempt state law purporting to regulate the operations of banks answerable to it. Its regulations nonetheless preempt conflicting state law, and where the OCC regulates the operations of banks, states will be preempted from implementing differing regulations.

Regulations promulgated by the OCC under the NBA, codified at 12 C.F.R. § 7.4009, express at least conflict preemption. Subsection (a) authorizes a national bank to exercise all powers available under federal law and subsection (b) provides that “state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its powers to conduct activities authorized under Federal law do not apply to national banks.” It also provides specific examples of areas (such as contract and tort law) that are “only incidentally affect the exercise of national bank powers” and therefore not preempted.⁵⁹

In *Bank of America v. City and County of San Francisco*, the court said that where a bank is federally authorized to perform operations, Congress has intended the federal authority to preempt inconsistent state authority and the ordinary presumption against preemption does not apply to banking regulations.⁶⁰ The preemption language is repeated specifically with respect to real estate lending powers in 12 C.F.R. § 34.4(a), with the same carve outs to protect the broad fields of law: “Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank’s ability to fully exercise its Federally authorized real estate lending powers do not apply to national banks.”⁶¹

Unlike the construction of TILA’s preemption language that favors consumer protection,⁶² the NBA’s language preempts state disclosure requirements which are not be preempted by TILA. The issue in *American Bankers Ass’n v. Lockyer*, revolved around disclosures on credit card statements ordered by the California legislature that were in excess of those required by the federal regulations. The district court said that the NBA and HOLA (along with the Federal Credit Union Act which regulates credit unions) preempted the state law even though TILA’s savings clause permitted the disclosure requirements.⁶³ Nothing in either HOLA or the NBA create a duty for national commercial banks to disclose the anti-deficiency protections a California homeowner enjoys, or to disclose that a homeowner loses them by refinancing. Under the reasoning of *Lockyer*, the duty present under California Civil Code section 2963 is preempted.

This result makes it difficult for states seeking to require disclosures by

59. 12 C.F.R. § 7.4009(c)(2) (2008).

60. 309 F.3d at 561.

61. 12 C.F.R. § 34.4(a).

62. See *Black v. Fin. Freedom Senior Funding Corp.*, 92 Cal. App. 4th 917, 936 (Cal. Ct. App 2002) (holding that TILA permits additional state disclosure requirements).

63. *Am. Bankers Ass’n v. Lockyer*, 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

a national commercial bank that are not already required under federal law. The Supreme Court has long held that the banking industry is regulated exclusively by the federal government, and the OCC zealously defends the proposition.⁶⁴ Accordingly, state law disclosure of anti-deficiency protection requirements are preempted for national commercial banks or against federally chartered savings institutions.

D. PREEMPTION OF STATE REGULATION OF OPERATING SUBSIDIARIES OF NATIONAL COMMERCIAL BANKS

Operating subsidiaries of national commercial banks make up the fourth category of lenders. They are unique among the other contemplated lenders in that they often represent the local branch of a national company. Despite this, operating subsidiaries of protected national banks are also protected by the National Bank Act. The OCC's regulations provide that state laws apply to subsidiaries in the same manner that they apply to the parent bank.⁶⁵

Despite previous decisions with respect to operating subsidiaries that suggested preemption would not apply, the Supreme Court has clarified that operating subsidiaries are protected from state regulation in the same manner as the parent banks.⁶⁶ This means that the same barriers that stand in the way with respect to federally chartered savings institutions and national commercial banks also prevent the enforcement of any requirement that the operating subsidiaries of national commercial banks disclose a purchase money mortgage consumer's anti-deficiency protection.

E. PREEMPTION OF STATE REGULATION OF FEDERAL CREDIT UNIONS

The fifth and final category of lenders is federal credit unions. Federal credit unions are defined in the FCUA as "cooperative association[s]"

64. See *Bank of Am.*, 309 F.3d at 561 (citations omitted).

65. 12 C.F.R. § 7.4006 (2008).

66. In *Spitz v. Goldome Realty Credit Corp.*, 600 N.E.2d 1185, 1188 (Ill., 1992), the court said that a subsidiary service company of a federal savings association would not be preempted where its parent would, and in 1995 the California Court of Appeals cited *Spitz* in *Fenning v. Glenfed, Inc.*, 40 Cal. App. 4th 1285, 1293 (Cal. Ct. App., 1995). In *Fenning*, the court held that the state law tort action for fraud would not be preempted against a subsidiary. However, the regulation the courts relied on in deciding *Spitz* and *Fenning* has been removed, and in 2003 the Ninth Circuit held that operating subsidiaries of national banks fall within the authority of the OCC, and were therefore exempt from the requirements of state law. *Wells Fargo Bank v. Boutris*, 419 F.3d 949, 965 (9th Cir. 2003); see also Julie R. Caggiano, *2004 Update on Residential Mortgage Lending (Including Preemption, RESPA, ECOA, and TILA) and Texas HELOCs*, 58 CONSUMER FIN. L.Q. REP. 308, 309 (2004). The Supreme Court restated this holding in *Watters v. Wachovia Bank, N.A.*, 127 S.Ct. 1559, 1571 (2007).

organized in accordance with the provisions of this chapter for the purpose of promoting thrift among [their] members and creating a source of credit for provident or productive purposes.”⁶⁷ Like the regulations governing other lenders, federal credit union regulations preempt state laws. However, unlike their companion agencies, the National Credit Union Administration (“NCUA”) has implemented conflict preemption with a very narrow scope of application. This coupled with its savings clause means that federal credit unions are the lenders most likely to be subject to state disclosure requirements.

The Federal Credit Union Act and the regulations promulgated by the NCUA to implement it are located at 12 U.S.C. §§ 1751-1795k and 12 C.F.R. Pt. 700, respectively.⁶⁸ The preemption language is found in 12 C.F.R. § 701.21, and, in subsection (b), says in part that the NCUA regulations preempt any state law purporting to limit or affect rates of interest and other charges and fees; terms of repayment; and other conditions. The regulation also states that “it is not the Board’s intent to preempt state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit”⁶⁹ The NCUA defers to other federal regulations and their preemption over relevant state laws but retains exclusive authority over violations of Federal or applicable state laws related to the lending activities of a Federal credit union.⁷⁰

Unlike its companion agencies, the National Credit Union Administration does not expressly preempt state regulation of consumer protection disclosure. Moreover, the savings clause specifically provides for TILA, which could potentially permit a state to require the disclosure of a purchase money mortgage consumer’s anti-deficiency protection. However, with respect to disclosure of terms to consumers of credit, federal credit unions are covered by TILA since they meet the qualifications under 12 C.F.R. § 226.1(c)(1), thus bringing them into the exemption of California Civil Code section 2958.

There is no duty for a federal credit union to disclose rights arising under state law to a purchase money mortgagor or loss of those rights upon refinance. Nonetheless, the FCUA does not prohibit the enforcement of such a duty under state law or the enforcement of such a duty by other federal law. In that respect it is more aligned with notions of federalism and more beneficial to efforts to protect consumers. Given the absence of a duty under California law for TILA-eligible lenders to disclose the anti-deficiency protection afforded to purchase money mortgagors in

67. 12 U.S.C. § 1752(1) (2000).

68. *Id.* §§ 1751-1795k (2000 & Supp. 2007); 12 C.F.R. § 700.

69. 12 C.F.R. § 701.21(B)(2).

70. *Id.* § 701.21.

section 580b, the issue of an action for failure to disclose remains unreachable. However, with respect to federal credit unions, it is one which can be remedied by state legislative action.

IV. CONCLUSION

The disclosure requirements of TILA, HOEPA, and TISA, along with those in California's Civil Code, protect consumers at the expense of lenders who view the disclosure requirements as an attempt to regulate their operations.⁷¹ This has had little impact on the disclosure requirements under federal law since TILA has been held compatible with HOLA, the NBA, and the FCUA.⁷² However, with respect to disclosure requirements arising under state law, it is difficult if not impossible for California to legislate any disclosure requirements that substantially differ from federal requirements because those that do will surely be preempted. Federally chartered savings institutions are regulated exclusively by the OTS, whose regulations preempt the field of thrift operation. State chartered savings institutions, though subject to some state controls, are also protected by the OTS when making alternative mortgage loans. National Commercial Banks and their subsidiaries are protected from state interference by the OTS and the OCC, as well as a long history of favorable precedent. Only federal credit unions can be subjected to state efforts to require disclosure, yet presently no duty exists.

One solution is that the pervasive scheme of federal preemption which prevents states from regulating the operations of lenders protected by federal law could be altered to allow states to require disclosure of material terms in loan agreements in addition to those required under federal law. California Civil Code section 2958 has such a requirement, but the existing duty to disclose is inapplicable to institutional lenders who are eligible to make disclosures under TILA. A second, more effective solution is that the federal agencies responsible for regulating the operation of mortgage lenders require the disclosure of state law debtor protections or the loss of those protections to borrowers, along with the other disclosures required under TILA. This would protect consumers who review the required disclosure document and eliminate the preemption issue altogether. A third solution would be to extend section 580b's protection to refinancing transactions involving either residential real estate generally or owner-occupied residential real estate as collateral. Although this would eliminate the problem caused by the current loss of anti-deficiency protection upon

71. *Id.*

72. *See, e.g., Sylvas v. E-Trade Mortg. Corp.*, 421 F. Supp. 2d 1315, 1321 (S.D. Cal. 2006); *Black v. Fin Freedom Senior Funding Corp.*, 92 Cal. App. 4th 917, 936 (Cal. Ct. App. 2002).

refinance, it would likely face substantial opposition from the financial services community and would be unlikely to succeed.

Of these options, the second proposal is probably the most effective at addressing the problem and would set up a regime that could recognize the differing borrower protections available in the several states, and the events that may cause their loss, much as the federal Bankruptcy Code allows state judgment exemption statutes to be incorporated into its otherwise nationally uniform scheme for adjusting the debtor-creditor relationship.

In any event, the current absence of a duty on the part of the vast majority of institutional home lenders to disclose section 580b's protection and its loss upon refinance means that unknowing borrowers refinance away their protections and have no recourse against the refinancing lender. This problem is only exacerbated by the fact that even if such a duty to disclose borrower protections were to be implemented under future state law, the state law would be preempted by federal regulations governing the operation of most institutional lenders. Without a disclosure requirement that applies to the majority of lenders, the current consumer protection in California Code of Civil Procedure section 580b is meaningful only to the most sophisticated borrowers — those who are least likely to need the protection.

While the implementation of a duty to disclose the protection, and the loss of it upon refinance, would increase the business costs of lenders,⁷³ the policy that a party to an agreement should be informed of the consequences of the agreement is not easily dismissed, and one could expect that a lender so burdened would pass on the costs to consumers. In the context of residential real estate finance, where one party is often a sophisticated lender in the business of originating loans secured by real estate and the other is often an unrepresented layperson, the determinative question is whether the cost of requiring disclosure is prohibitive.

73. See, e.g., *Wells Fargo Bank v. Boutris*, 419 F.3d 949, 969 (9th Cir. 2003).