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Sixth Circuit Sustains Office of Thrift Supervision Preemption of State Mortgage Broker Registration Requirements

The United States Court of Appeals for the Sixth Circuit recently ruled in *State Farm Bank, FSB v. Reardon* that the Office of Thrift Supervision's ("OTS") lending regulations preempt the Ohio mortgage broker licensing law as it applies to the exclusive agents of a federal savings association. The longer-term impact of this decision is uncertain because of the passage of the Housing and Economic Recovery Act of 2008 ("Recovery Act").

State Farm Bank, FSB, a federal savings association, used agents of its parent company, State Farm Mutual Automobile Insurance Company, as independent contractors to offer financial products and services to the public. The exclusive agents' performance was subject to examination by the OTS to the same extent as if State Farm Bank itself performed those activities.

Ohio asserted that the exclusive agents were also subject to Ohio law and were required to obtain mortgage broker licenses from the state. The OTS issued an opinion asserting that they were not. When Ohio refused to exempt State Farm Bank's exclusive agents from the state's mortgage broker licensing law, State Farm Bank sued the state in federal court, and the district court ruled in favor of Ohio. On appeal, the Sixth Circuit rejected the lower court's analysis based on the legal relationship between State Farm Bank and its exclusive agents as "too formalistic." It held that the Supreme Court's decision in *Watters v. Wachovia Bank, N.A.*, required it only to consider whether the state's exercise of supervisory power would hamper "in more than an incidental manner" State Farm Bank's exercise of its banking powers. The question was not who was regulated, but what activity was regulated, and whether state regulation of that activity would defeat the purpose of federal law intended to protect federally chartered institutions. Otherwise, the states, by denying federal savings associations the tools available to others to engage in permissible activities, would be able to regulate indirectly what they were prohibited from regulating directly. Accordingly, the Sixth Circuit ruled in favor of State Farm Bank's preemption claim.

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The Sixth Circuit acknowledged that the effect of its decision may be limited because the Recovery Act, which was not under review, authorizes the states, subject to certain minimum federal requirements, to license mortgage brokers who are not employees of a bank or thrift or a federally regulated subsidiary. While *Watters* and *State Farm Bank* indicate that federal thrifts and national banks will generally continue to be afforded broad protection from state regulation, certain mortgage lending arrangements may need to be reevaluated in light of the Recovery Act and potential state actions thereunder.

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