STATE AG TRACKER
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ISSUE BRIEF

State Attorneys General and Regulation of National Financial Institutions

By Margaret A. Little

Recently, Connecticut Attorney General Richard Blumenthal issued a press release, joined by all 49 other state attorneys general, in which he advanced two propositions. First, he claimed that a Bush Administration Office of the Comptroller of the Currency (OCC) regulation had hamstrung the states from regulating national financial institutions, thereby directly contributing to the financial crisis, saying:

> The Bush administration flagrantly favored national banks over consumers, exempting them from state regulation and helping set the stage for the ongoing economic meltdown. This rule was a key element in the perfect storm that devastated the mortgage market, turning the American Dream of home ownership into a nightmare and wrecking our economy. Without this rule, states could have stopped abusive practices, slowing or even preventing the current crisis.

Second, he urged the Obama administration to join with the 50 state AGs in urging the U.S. Supreme Court in *Cuomo v. Clearing House Association,* 08-453, to overturn the OCC regulation and permit the states to regulate national lenders.

The Office of the Comptroller did not take the state AGs up on this invitation. Instead the Comptroller's office filed a brief in *Clearinghouse* seeking to extend its exclusive federal power further than ever, asserting that even when state laws do apply to national banks, the Comptroller alone—not state authorities—holds the power to enforce them.

The Federalism Issue on Appeal

Less than two years ago, in *Watters v. Wachovia,* 127 S. Ct. 1559 (2007), the Supreme Court addressed the question of whether a wholly owned mortgage lending subsidiary of a national bank could be regulated by state banking authorities, or whether the same OCC regulation preempted such state regulation. The banking industry and national financial institutions argued that the OCC regulation was a reasonable interpretation of the National Banking Act, and that parallel regulation by state and federal authorities would be inefficient and wasteful, and would ultimately lead to higher costs for consumers. The majority opinion, written by Justice Ginsberg and joined by Justices Kennedy, Souter, Breyer, and Alito, rejected the state's claim of parallel authority. Justice Stevens, joined by Justices Roberts, and Scalia in dissent, argued that preemption should be based upon an explicit federal statute, not a mere OCC regulation, and that the majority opinion failed to give due respect to the historic dual banking system.

Reasonable observers of the dual banking system can have an honest debate about whether the states retain such regulatory authority until such time as a statute, as opposed to a regulation, removes state regulatory powers. Indeed in *Watters* some of the most conservative justices joined with Justice Stevens in taking this view.

What should not escape notice is that this recent press release and state AG activity seeks to perpetuate a template of states engaging in regulation through litigation that has substantially extended state regulation beyond its traditional scope over the past two decades.

The Factual Regulatory Background

The history of AG activity over the past decade reveals no evidence that there

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was any attention being paid at all by state regulators to sub prime lending, Fannie Mae or Freddie Mac—except attempts like New York AG Spitzer's in *Clearinghouse* to force banking institutions to extend credit to larger pools of borrowers with greater creditworthiness risk. Only recently did the state AGs assert the need for regulatory action in the housing sector.

The Bush administration made attempts to provide more regulatory oversight of Fannie Mae and Freddie Mac—and such efforts were opposed in Congress. Both Senator Chris Dodd (CT) and Congressman Barney Frank (MA) resisted efforts to provide more oversight over this lending, calling such administration proposals unserious and unnecessary. As recently as the summer of 2008, when the mortgage markets began to constrict, Dodd called on Bush to "immediately reconsider his ill-advised" reform proposals, and Frank stated that the president's suggestion of a strong independent regulator of Fannie and Freddie was "inane."

Understanding the Causes of the Current Economic Downturn

The causes of the economic downturn of 2008-9 will be debated for years to come, and we may never fully understand them. A fair reading of assessments across the spectrum of opinion is that the Fed's policy of keeping interest rates low in the first years of the 21st century and high savings rates in Asia and the rest of the world led to increased prices of long-lived assets. The bubble in housing value was accompanied by government policies such as the Community Reinvestment Act followed by Fannie Mae and Freddie Mac that put many sub-prime borrowers into housing debt. Escalating housing values led to increased lending and borrowing based upon expectations that housing values would continue to escalate at rates we now know were not sustainable. The interplay between European Central Bank and Fed rate decisions, and international exchange rates may have also been factors.

To date, there is no scholarship indicating regulatory activity by state attorneys general or banking regulators would have been able to influence Fed interest rates, international savings practices, or counteract the effect of federal legislation and a regulatory environment that was putting more and more borrowers into homes whose inflated values would not support the debt thereon. Accordingly, policymakers should carefully examine the root causes of the current economic crisis in assessing what legal or regulatory responses are appropriate, and view with some skepticism the claim by the state AGs that limits on their powers to regulate national banks, credit card companies, and other national financial institutions has in any way contributed to the economic downturn.

** Margaret A. Little is an attorney in private practice in Connecticut representing businesses and financial institutions in litigation and appeals in state and federal courts. A graduate of Yale College and Yale Law School, Ms. Little clerked for the Hon. Ralph K. Winter on the United States Court of Appeals for the Second Circuit.*

State AG Tracker

In an effort to increase dialogue concerning the role of state attorneys general, The Federalist Society's State AG Tracker highlights recent activities of attorneys general across several states. Some argue that state attorneys general overstep their roles by prosecuting cases and negotiating settlements with extraterritorial and sometimes national consequences. Others contend that they are simply serving the interests of their own citizens and filling a vacuum left by the failure of other state and federal agencies to address these issues. State AG Tracker will draw attention to these matters by publishing submissions regarding recent activities of state attorneys general.

Opinions expressed herein do not necessarily reflect those of the Federalist Society. We invite readers to submit pieces for publication to info@fed-soc.org.

The Federalist Society
for Law & Public Policy Studies
1015 18th Street, N.W., Suite 425
Washington, D.C. 20036