Dodd Frank UPDATE

What states can, cannot do to supervise financial marketplace

Banking, Consumer Protection

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As the Consumer Financial Protection Bureau (CFPB) continues to advocate for **cooperation** between state attorneys general and federal regulators, under acting director Mick Mulvaney, and state AGs recognize the importance of cooperating with their state-level counterparts when pursuing bad actors, the process of enforcing consumer financial protection laws could become more multi-faceted than ever moving forward.

There are a variety of questions the financial industry may have regarding what states can and cannot do in terms of supervising the financial marketplace, a task which, historically, has fallen mainly to federal regulators.

How much autonomy do states have when it comes to supervising the financial marketplace? What are their limitations? How are their offices structured?

These are some of the questions *Dodd Frank Update* asked Buckley Sandler Partner Jonice Gray Tucker to get a sense for how state attorneys general may be able to ramp up their enforcement activity in the financial space.

Authority

States have various options for taking action against financial companies for harming consumers.

“It rises and falls on an AG’s jurisdiction,” Tucker said. “They can pursue cases under their own state laws and they can pursue cases under certain federal laws as well.”

During the era of regulation by enforcement, which Mulvaney has said is coming to an end, the CFPB used the Dodd-Frank Act provision prohibiting unfair, deceptive or abusive acts or practices (UDAAP) to attack a variety of activities, Tucker said, using novel and, sometimes, aggressive theories. Dodd-Frank allows states to invoke the federal UDAAP statute at their discretion.

“States generally have the ability, with a few caveats, to bring cases under federal UDAAP,” Tucker said. “That was a power that was conferred by Dodd-Frank. And they can go after many, but not all, of the companies operating in the financial services space directly under federal UDAAP.”

Many states also have their own provisions allowing them to pursue claims for unfair or deceptive practices which closely mirror the Federal Trade Commission's (FTC) UDAP authority, and, consequently, have come to be commonly referred to as "Baby FTC Acts."

"There are some question marks around the degree to which, under federal UDAAP, a state could bring a case against a national bank or federal savings association based on the statutory language of Dodd-Frank," Tucker explained.

Preemption

Tucker cited Dodd-Frank's codification of the preemption decision in *Cuomo v. The Clearing House Association, LLC* as a cause for confusion regarding the scope of federal UDAAP as applied to national banks and federal savings associations by state AGs. The statute enables any state AG to "bring a civil action in the name of such state against a national bank or federal savings association in any district court of the United States in the state or in state court . . . that has jurisdiction over the defendant to enforce a regulation prescribed by the bureau under a provision of this title," according to 12 U.S.C. § 5552(a)(2)(B).

"But," Tucker noted, "a state attorney general cannot bring a civil action against a national bank to enforce a statutory provision of Dodd-Frank. This is commonly interpreted as a bar against state attorneys general from enforcing the UDAAP provisions of Dodd-Frank against national banks, which currently appear only in the statute itself, and are not set out in any regulation. This limiting provision of § 5552(a) stands in contrast to the more generally applicable provision covering other entity types, and which allows state attorney generals to bring civil actions to enforce provisions of [12 U.S.C. § 5552(a)(1)]."

With respect to national banks, which are regulated by the Office of the Comptroller of the Currency (OCC), Tucker noted that there are some long-standing issues of preemption that place limitations on states' abilities to investigate such entities. Such investigative authority commonly is understood to be a type of visitorial power. Visitorial powers include, among other things, conducting examinations, inspecting or requiring production of books or records, as well as regulation and supervision of activities authorized or permitted pursuant to federal banking law, Tucker added. The OCC is understood to have exclusive vistorial power with respect to national banks.

"This sets up an interesting situation because, with respect to certain types of financial institutions, state AGs have greater autonomy to investigate," Tucker said. "But, with national banks, it's complicated. They can't just investigate as they would with other banking and non-bank entities. There are significant limitations and they may, theoretically, have to move directly to a lawsuit."

An interesting and closely related issue is the question of what laws are, and are not, preempted. States are able to enforce non-preempted statutes. The issue of what state laws are and are not preempted came up in the Ninth Circuit Court's case of *Lusnak v. Bank of America*. The court ruled that the National Bank Act does not preempt California's state escrow interest law and recently denied Bank of America's motion for an *en banc* rehearing of the case. **State-by-state basis**

Among the notable examples of states ramping up their consumer financial protection activities are Maryland, New Jersey, Virginia and Pennsylvania.

The latter of the four turned heads when it launched its own version of the CFPB, dubbed the “mini-CFPB” by some, in July 2017. The unit’s stated focus is on lenders who take advantage of seniors, families with students and military service members, including for-profit colleges and mortgage and student loan servicers. Pennsylvania AG Josh Shapiro heads up the state’s Consumer Financial Protection Unit with former federal CFPB enforcement attorney Nick Smyth, who he appointed as assistant director of the new entity.

“Protecting the public from financial scams is a key priority of mine, and Nick Smyth will help us expand our capacity to bring complex cases against financial companies that try to rip off Pennsylvanians,” Shapiro said in a statement.

Similar to the federal CFPB, Pennsylvania’s version tracks consumer complaints about potential wrongdoing by companies and makes efforts to educate the public about responsible fiscal habits and potential scams to watch out for. In April 2018 the Pennsylvania AG office published a notice stating that it had received 15 complaints from consumers about mortgage modification scams in the first few months of the year, compared with 61 complaints the previous year. Such a notice is reminiscent of periodic complaint reports published the CFPB published under the direction of Richard Cordray.

Perhaps less publicized but no less noteworthy, especially given its structure, is Maryland’s Financial Consumer Protection Commission, which was formed in June 2017.

“The commission is to assess the impact of potential changes to federal financial industry laws, regulations, budgets, and policies,” according to the commission’s description posted on Maryland’s official state website. “This includes changes to the federal Dodd-Frank Wall Street Reform and Consumer Protection Act; the Consumer Financial Protection Bureau; the Securities and Exchange Commission; the Commodities Futures Trading Commission; the Pension Benefit Guaranty Corporation; the U.S. Department of Labor; the Federal Reserve Board; and any other federal financial regulators. Further, the commission will recommend ways to protect Marylanders in financial transactions and services.”

Just as they can form their own versions of federal agencies, they can enact their own versions of federal laws as well.

“Virtually every state has a miniature form of UDAP in the form of its own state law that typically prohibits unfair and deceptive trade practices,” Tucker said. “And that’s often the easiest vehicle under which a state AG could pursue an action against an actor in the financial services space. The abusiveness component is not there but the other components typically are. Abusiveness is usually the primary distinguisher because that is what was new in the federal UDAAP statute.

“In addition, states have their own consumer protection laws,” she added. “Many have their own fair lending laws as well as other laws that would prohibit problematic activity with delivering consumer financial products and services.”

Because states have their own state consumer protection laws, they may not even have to look to federal statutes for the authority required to pursue financial institutions. She noted that numerous federal consumer protection laws also give states a right of action.

Virginia AG Mark Herring actively has been working to increase awareness of predatory lending practices, urging residents in his state to familiarize themselves with the risks associated with short-term, small-dollar loans such as payday, auto title, open-end and online loans, and to educate themselves of their rights when utilizing such forms of credit.

“Too often these small dollar loans that seem like a lifeline wind up being financial quicksand,” Herring said in a press release in March 2017. “It’s not uncommon to see a few hundred dollars intended to get a borrower through a tough few weeks balloon into a few thousand dollars that remains unpaid months or even years later. The laws to protect Virginians against this kind of predatory and abusive lending are not nearly as strong as they need to be. That’s why it’s so important for Virginians to understand the risks associated with these products, to carefully review any terms and understand your own ability to repay the loan, and to consider any alternatives that may be available.”

Banding together

One of the most glaring differences between federal and state consumer protection agencies is in the amount of available resources to pursue cases against financial entities.

“A vehicle we’ve seen used more and more over the last several years and that I fully anticipate is going to continue is the use of multi-state investigations,” Tucker said. “Those are situations where two, five, 15, or even all state AGs band together and conduct an investigation jointly. And when you put that patchwork together, you may cover a substantial part of the country because you’ve got AGs from many different states who are looking at the practices of that particular institution.”

A prime example of states effectively banding together to take on a national company is a case against New Jersey-based PHH Corp. over improper mortgage servicing and foreclosure practices. Forty-nine states took part in the lawsuit, which resulted in a $45 million settlement in January.

States could end up doing much more on their own to regulate financial institutions going forward if they so choose, Tucker said, particularly if they have relevant state laws covering the conduct at issue, or alternatively, are able to use their own UDAP statutes, which are typically quite broad.

States not only have banded together to go after those they perceive as bad actors but to voice their collective opinions on some of the very measures used to protect consumers.

In July 2017, Shapiro joined 19 other state AGs in sending a letter to Senate leaders defending the CFPB’s rule banning forced arbitration agreements.

“The arbitration rule protects consumers’ legal rights when they’ve been ripped off by a financial services company,” Shapiro said in a statement. “Access to the civil justice system is a fundamental right for every Pennsylvanian and American, and I’ll fight to protect those rights.”

Seventeen AGs from around the country wrote to President Donald Trump stating their intention to continue enforcing consumer financial protection laws even if the CFPB was to curtail its enforcement activities under the interim leadership of Mick Mulvaney.

“Regardless of the future direction or leadership of the CFPB, we as state attorneys general will vigorously enforce state and federal laws to ensure fairness and deter fraud,” the AGs wrote.

The letter was signed by AGs from California, Connecticut, the District of Columbia, Hawaii, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, North Carolina, Oregon, Vermont, Virginia and Washington.

Despite the efforts of the states and the arbitration rule's other supporters, Trump signed a Congressional Review Act measure nullifying it in November 2017.

It pays to cooperate

Notwithstanding preemption, national banks and federal savings associations sometimes consider working with state regulators confidentially insofar as the state AG has concerns, Tucker said, as they do not want to end up on the wrong side of a regulator or cause the state AG to pursue a lawsuit because they have no other recourse to resolve concerns.

Cuomo, which escalated to the Supreme Court, arose after then-New York AG Elliot Spitzer sent a letter to a variety of national banks in lieu of a subpoena, seeking non-public information about those entities' lending practices in an attempt to find out whether those banks had violated New York's state fair lending laws. The OCC and The Clearing House each filed separate suits to enjoin the AG, claiming that the AG's investigation and threat of enforcement action infringed on the OCC's exclusive visitorial authority.

"A core question was the way in which the state AG could enforce non-preempted laws against national banks. Were New York's actions permissible?" Tucker said.

The Supreme Court ultimately ruled that the OCC's interpretation of its own visitorial power was too broad.

"In a nutshell, the court held that when a state AG brings a lawsuit to enforce state law against a national bank, he/she is not acting in the role of a sovereign supervisor but rather in the role of a sovereign law enforcer," Tucker said. "So, this puts some parameters around what is considered visitorial and, therefore, what is considered permissible and impermissible for a state AG."

Whether it's between state AGs and the CFPB, states and other states or industry participants and state regulators, it seems the future of consumer financial protection law enforcement and regulation of financial institutions may not recede. This may drive the need for more cooperation than ever before for industry players who seek to work through issues with government regulators consensually.

"In addition to state AGs, state banking regulators are also increasingly aggressive across the board in asserting their jurisdiction, rigorously examining the numerous entities under their jurisdiction, and bringing enforcement actions," Tucker added. "One tool they have that the state attorney general does not is to seek to revoke an entity's license to do business. Because the license revocation process would eliminate the entity's ability to do business in that state, and because of the cross-notification requirements to the other regulators and to financial counterparties like warehouse lenders, these adversarial actions can create special risks that require sophisticated assistance to navigate."