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Regulatory Power Moves to the States: What This Means for Companies

Despite the current momentum of federal deregulation, state agencies are buttressing consumer protections and ensuring there is no lapse in enforcement. State attorneys general are leading a charge into the perceived vacuum where federal agencies — including the Consumer Financial Protections Bureau — have retreated.

Ashley L. Taylor, Jr. shares his in-the-trenches view of the regulatory landscape and explains why the decentralization of oversight demands a more strategic, proactive approach to compliance.

How is the regulatory landscape changing today?

Taylor: Federal regulatory activity diminished, as expected, after Republicans took control of the White House and both chambers of Congress last year. But in the immediate aftermath of that pullback, states stepped in to fill the void. There's a relationship among state attorneys general, and they are working collectively to shape national policy. State AGs and their regulatory bodies — licensing divisions, banking divisions, bureaus of insurance — are becoming more engaged in investigations and enforcement actions.

Is it a passing response to deregulation?

Taylor: It's a trend, and the trend is accelerating. State regulators have increased their activity during Trump's presidency but they were not dormant during the Obama administration, either. It doesn't matter who is in control. Power is moving to the states.

What is the genesis of states driving regulation?

Taylor: I would mark the National Tobacco Settlement of 1998 as a seminal moment. The commerce committee in the U.S. Senate debated an omnibus bill to settle all tobacco claims and create a pool of money for consumers, but the deal fell through. The state AGs who had been monitoring the deal stepped forward when the Senate-proposed global resolution failed. Everyone remembers there was a national settlement paying billions of dollars but they forget that the states were waiting for the feds to act. That was the foundation of multistate cooperation.

Is there uniformity across states or is it a patchwork of regulation?

Taylor: It varies from state to state, and that's the crux of the issue. The states learned in the Tobacco Settlement that they didn't each need to be experts in everything; knowledge could be shared. As a result, you find this clustering of expertise at the state level. For online lending, it's Virginia. For subprime auto lending, Massachusetts. The most active states in terms of regulatory activity right now are California, Illinois, New York, North Carolina, Massachusetts and Virginia. I would identify a second group in terms of regulatory activity which includes Arizona, Florida, Oregon and the District of Columbia.

Historically, businesses could look to the Federal Trade Commission, now the CFPB, to create a national compliance program, but that approach does not work in this decentralized regulatory environment. Instead, you must identify state case law relevant to your business, and then overlay the case law with the states most active in your industry.

How does a business determine which states are active in its industry?

Taylor: Without a broad-based consumer protection team operating in multiple industries across the country, you

won't know which state is the expert in which area. There's no easily accessible database in this area. Settlements and regulatory activity are a matter of public record but nobody knows how to access the information. A business won't understand its exposure unless it is working with a firm grounded in state regulatory enforcement and private lawsuits related to those issues.

How do you develop a comprehensive compliance program against decentralized agencies?

Taylor: We create a national "heat map" for clients. It's a color-coded map showing which states pose the greatest and least risk for a specific business. The information is predicated upon industry and state law, but most importantly it shows current enforcement activity by state. We tap into our database of cases, which is updated daily from the matters our attorneys are working on. That input is synthesized to generate a statistical formula of the client's unique risk profile, state by state. The activity in any given state is always evolving, so we monitor and adjust the map to reflect current trends and enforcement policies. With that information we can provide risk rankings and probabilities to compliance officers and general counsel with a high degree of specificity.

What is the state attorneys general "class action project"?

Taylor: In 2005, Congress passed the Class Action Fairness Act, or CASA. It requires the parties presenting a federal court with a potential class action settlement to send the proposed settlement to every state AG in the country, giving AGs the opportunity to object or participate in the case. That in turn created a structure within the National Association of Attorneys General for analyzing every national class action settlement. Settlements are analyzed by a class action review committee. The committee then makes recommendations about whether to object or intervene — or they may open an investigation right after the settlement occurs. Each state retains independent authority, but they collaborate to maximize impact. There's no reason a state can't open an investigation after a class action has been settled.

Having to defend a class action and a regulatory action may be an existential threat for the businesses.

Taylor: Many competent law firms can handle class actions; very few have experience handling parallel class actions and enforcement matters, which demands a very specific skillset. That's a point of distinction. The plaintiffs' bar has begun to recognize the tremendous pressure companies face in parallel enforcements. As soon as there is a public filing of allegations, say for a misleading contract or operating without a license, all a state attorney general needs to do is monitor the court's docket. Then they pull the complaint, attach a copy to the federal court exhibit, and send a letter to the company saying, "The state is concerned and has statutory authority to demand documents. Give us the documents of this contract for all the consumers in our state." That's all it takes for an investigation to be underway. Companies have a blind spot if they are handling class actions without an understanding of the looming regulatory threat.

Are the states tightening restrictions or just becoming more vigilant about enforcement?

Taylor: We're seeing more aggressive interpretations and activity rather than a wholesale change of the law.There are changes in the interpretation of long-standing statutes. Statutes may have been read a certain way for 20 years, but now some states are deciding to be more aggressive. My sense is that the regulators recognize they must vigilant in order to remain current given advances in technology.

In the last major wave of enforcement, regulators moved from one industry to the next. Why is the financial services industry in the crosshairs?

Taylor: There's so much innovation in the industry. Companies are developing new products at a remarkable pace — particularly in FinTech, where financial products and technology intersect. Consumers have more choice and more control, and there appear to be lower barriers to entry for new businesses. The regulators struggle because technology is outpacing the law.

Still, what's more likely to change: A federal law or a state law?

Taylor: States are acting faster.

Ashley Taylor is a partner in the Consumer Financial Services practice at Troutman Sanders. He focuses on federal and state government regulatory and enforcement matters involving state attorneys general, the Consumer Financial Protection Bureau (CFPB), the Federal Trade Commission (FTC) and related litigation.