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Let's Keep Many Eyes on the Banks
The move to centralize regulation doesn't make sense.
By RICHARD H. NEIMAN

The nation is about to make two momentous policy choices about the future of our financial system. One will be made by the president, the other by the Supreme Court. Both decisions involve the proper roles for state and federal regulatory authority, and both have far-reaching consequences. Yet the country seems barely aware of the issues, or the stakes involved.

The Bush administration promulgated a blueprint for financial regulatory reform in March 2008 that proposed a single federal regulator with virtually no role for state authorities. The Obama administration will shortly announce its own restructuring plan. It should take a fresh approach by including a significant role for the states. This is necessary to maintain checks and balances and protect consumers from predatory lending and other abusive practices.

A move toward complete centralization would be a serious mistake. In an increasingly complex financial-services landscape, we need the local perspective for early detection of emerging risks. States like New York and North Carolina sounded the first alarm on predatory lending issues more than 10 years ago. Unfortunately, instead of cooperating, the primary federal regulators -- the Comptroller of the Currency and the Office of Thrift Supervision -- thwarted state efforts as far back as 2003 by aggressively asserting that federal law pre-empts state law. This exacerbated the subprime crisis by allowing federal banks and thrifts to avoid state antipredatory lending laws.

State supervision also fosters thousands of community and regional banks that provide diversity and stability to our financial system. These smaller banks largely steered clear of the exotic mortgage lending that triggered the subprime crisis, and they are responsible sources of hometown lending. A single federal regulator would tend to focus on the largest institutions to the detriment of smaller ones that benefit from close interaction with local regulators in developing innovative products for the communities they serve.

The second big issue involves the ability of states to enforce valid laws already on their books. The Supreme Court is deliberating the case of Cuomo v. Clearinghouse, which will determine whether state attorneys general or the federal regulator alone can enforce fair lending and other consumer protection laws against national banks.

A decision against the states would result in a perverse situation in which states would be forced to stand by while their laws are violated. States must be able to ensure that financial institutions, like any other businesses, comply with their laws. We want more "cops on the beat," not fewer.

I urge President Barack Obama and Treasury Secretary Timothy Geithner to see this moment in history as an opportunity for establishing a cooperative federalism to bring together the unique expertise and resources of each level of government in a more coordinated approach.

We have much to lose by any well-intentioned but perilous experiment in extreme centralization. If such an experiment does not live up to expectations, there would be no simple way for states to restore their authority and the balance of power. Authority once relinquished is seldom regained.

As Thomas Jefferson so aptly warned in a letter to George Washington in 1791, for the federal government to overstep the boundaries of the states is "to take possession of a boundless field of power, no longer susceptible to any definition."

I appreciate that centralized oversight has competitive advantages in a globalized marketplace. But we can harness those advantages without sacrificing the flexibility and accountability of our more decentralized model. Our country's banking system can combine the efficiency of Hamilton with the soul of Jefferson. We always have, and the creative tension between the two approaches is an important aspect of our national heritage.

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