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New York and California Are Leading States in Pushing for More State-Level Consumer Protection Actions

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As reported by the Wall Street Journal on March 16, 2020, states like New York and California want more power over the financial sector due to what is perceived as a lack of Consumer Financial Protection Bureau ("CFPB") action by the federal government.[1]

Both states have pushed for significant expansions of regulatory powers over the financial services industry to remedy what has been a steady decline in public enforcement cases by the CFPB since 2015.[2]

California Proposal

In California, Governor Newsom's proposal would expand and restructure its existing consumer protection laws, increasing its Department of Business Oversight's budget from $103 million to at least $122.3 million and adding 90 positions to the Department's current number, 16 of which would be solely focused on enforcement.[3] California's proposal includes a rebranding of its Department of Business Oversight as the Department of Financial Protection and Innovation.[4] The Department would have expanded authority "to pursue unlicensed financial service providers not currently subject to regulatory oversight," which would include "debt collectors, credit reporting agencies, and financial technology companies, among others," and thereby facilitate the Department's ability to police alleged predatory practices.[5] California would also create an Office of Financial Technology Innovation, tasked with anticipating trends in financial products to preemptively curb practices that are viewed as possibly harming consumers.[6]

New York Proposal

As part of the proposed expansion of powers, Governor Cuomo's proposal would provide the New York Department of Financial Services ("NYDFS" or "DFS") with authority to seek larger financial penalties and expand its investigatory abilities.[7] The new proposal would also permit the DFS to impose civil penalties on companies engaged in certain types of fraud—and could do so even without a showing that the fraud was intentional.[8] This is in line with New York's Martin Act, one of the strictest state securities fraud statutes in the country.[9]

As part of its proposed expansion, the proposal would allow NYDFS to bring actions against unlicensed financial entities in the same manner as it would against a licensed entity, expands the definition of a

New York-regulated “financial product or service,” and increases the statutory fines that NYDFS may assess. Specifically, the definition of “financial product or service” would be expanded to include “the sale or provision to a consumer or small business of any security . . . .”[10] Adding securities to the definition of “financial product or service” is noteworthy and the proposed changes would give NYDFS the power to regulate the provision of investment advice. Further, the proposal would eliminate the previous statutory exceptions to the definition of “financial product or service,” which previously excepted products or services already regulated by another state or federal agency from NYDFS’s authority. If enacted, this proposed change would effectively make NYDFS another securities regulator with potentially overlapping enforcement authority. In addition, the proposed definition of “financial products or services” would now include those offered or sold to small businesses, defined as any independently owned and operated business with less than $10 million in annual gross receipts or sales and with fewer than 100 employees.[11] This provision would thus create regulatory oversight of business-to-business transactions, which had previously been largely insulated from state consumer protection actions.

The proposal increases the penalties that NYDFS may assess, insofar as they relate to any purported fraudulent, misrepresentative, unfair, deceptive, or abusive acts or practices. Under current law, NYDFS can assess penalties of no more than $5,000 per transgression. The new fines would amount to the greater of (1) $5,000; (2) a multiple of two times the aggregate damages attributable to the offense; or (3) a multiple of two times the aggregate economic gain attributable to the offense.[12] The proposal would also allow restitution in addition to other penalties or sanctions.[13] The statute of limitations for claims under both New York Executive Law §63 (12) (consumer protection) and the Martin Act (investor protection) was already changed in June 2019 from five to six years,[14] giving New York the ability to look further back in investigating these types of actions.

The New York and California proposals will be up for approval during budget negotiations, which are due to be finalized by March 31 and June 15, respectively,[15] although these dates may change given the current coronavirus pandemic.

NYDFS’s Appointment of New Superintendent Linda Lacewell

In addition to the proposed expansion of its regulatory powers, New York has already taken significant measures to take matters into its own hands. In June 2019, the DFS appointed Linda Lacewell as the new superintendent, replacing former superintendent Maria Vullo.[16] Previously, a federal prosecutor and top aide to Governor Cuomo, Superintendent Lacewell emphasized her interest in the financial technology industry during her testimony before the Senate Finance Committee, stating “It’s actually the job of DFS not only to regulate banking and insurance, but to keep an eye out for emerging products like bitcoin, fintech, and other areas. It’s part of our responsibility to look there to identify those issues and to try to responsibly regulate in a careful manner.”[17] Superintendent Lacewell further signaled her prioritization of the financial services and technology sector early into her role, announcing the creation of a new Research and Innovation Division of the NYDFS in July 2019.[18] The new Division is specifically positioned to focus on regulatory and compliance topics in emerging industries, including the financial technology sector.[19] The new Division will also assume responsibility for licensing and supervising entities engaged in virtual currency business activity under NYDFS’s BitLicense Regulation.[20]

Recent NYDFS FinTech Investigations

New York has also demonstrated its current commitment to the regulation of the FinTech industry through a number of recent enforcement investigations in the sector.

In August 2019, NYDFS launched a consumer protection investigation of the early access to earned wages industry, which was joined at the time by 11 other state banking regulators, on issues involving alleged online lending, voluntary tipping, monthly membership fees, and other consumer fees.[21] The NYDFS and other state regulators are focused on whether the models of the individual apps are engaged in prohibited payday lending-type practices under various usury, licensing, and other consumer protection laws.[22] A flood of subpoenas was issued right away, less than two months after Superintendent Lacewell started in her new role. These investigations are still pending.

In September 2019, the NYDFS also announced the launch of an investigation into the student debt relief industry.[23] As part of this investigation, NYDFS subpoenaed eight companies to examine allegations that the companies are engaging in deceptive practices by improperly charging large fees in the form of monthly subscriptions to consolidate loans while failing to inform borrowers of federal programs that exist offering the same services for free.[24] This investigation is one part of the DFS's "Step Up for Students" Initiative, which was created by the NYDFS in 2019 to protect student loan borrowers from unfair practices relating to these loans.[25]

In October 2019, the NYDFS successfully challenged the authority of the Federal Office of the Comptroller of the Currency ("OCC") to create a federal bank charter that would allow non-depository financial technology institutions to circumvent current regulation requiring each company to obtain licenses from any state in which it wishes to operate.[26] Rather than requiring FinTech companies to go through this process, the OCC proposed granting a special-purpose national bank charter.[27] On October 21, 2019, the Southern District of New York ruled in favor of the NYDFS, entering a final judgment preventing the OCC from issuing the proposed charter.[28] The OCC plans to appeal the case to the Second Circuit.[29]

NYDFS BitLicense Regulation

In addition to enforcement investigations, the NYDFS has further demonstrated its attention to the financial technology industry through adapting its guidance in an attempt to keep up with an ever-changing market.[30] In December 2019, the NYDFS took steps to review its controversial "BitLicense" regime—which governs virtual currency activities in the state—and proposed new measures for licensed virtual currency firms. The guidance is designed to streamline the process of listing new coins to a firm's existing products and would create an online, public list of pre-approved coins. The guidance would also provide licensed virtual currency companies with a "model framework" for coin-listing from which an existing licensee will be expected to create its own policy to submit for DFS approval. If approved, the licensee will be permitted to self-certify the listing of additional currencies in line with this policy—eliminating the need for prior approval from DFS. The new measures may provide ease to what has otherwise been seen as a rigorous state regulation by many cryptocurrency companies.

Anticipated Impact

The NYDFS's and California's recent actions signal continued concentration on FinTech, while simultaneously pursuing, together with other state regulators, legal challenges to federal oversight of FinTech companies. We can expect that the steps taken by the NYDFS, California, and other state regulators will be viewed as impediments to market innovation, including the operational burdens associated with compliance with states' separate regulations, which are often broader in scope than their federal counterparts. Market participants should proactively assess compliance protocols given the expected strengthening of state and local regulatory monitoring and enforcement activities. Close attention will need to be paid to state regulatory actions and enforcement views in order to best navigate this evolving landscape. Moving forward, companies should consider allocating increased resources to cover new compliance and monitoring costs as states increase and expand consumer protection investigations.

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If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings New York lawyers:

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