Regulatory Report

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FEATURE ARTICLE

State Banking Regulators File Suit Challenging OCC Fintech Charter

By Ashley L. Taylor, Jr., Keith J. Barnett and C. Reade Jacob, Jr.

On April 26, a group of state bank regulators filed a lawsuit to block the Office of the Comptroller of the Currency from issuing special charters to fintech firms. The regulators argue that the OCC fintech charter will improperly displace already effective state laws regulating fintech companies, that the OCC lacks the authority to issue charters to fintech firms because fintech firms do not engage in the business of banking, and that the OCC failed to go through the necessary notice and comment rulemaking as required by the Administrative Procedures Act.

In December 2016, the OCC announced plans to issue special purpose charters to fintech firms. The charters would allow fintech firms that collect deposits, issue checks, or make loans, among other traditional banking activities, to have a single national standard for their operations, allowing them to operate across the country in exchange for strict oversight, according to the OCC. Although the OCC has not formally defined "fintech," the term is generally understood to encompass a broad array of technology-driven financial services providers, including third-party payment processors.

The Conference of State Bank Supervisors, a nationwide organization comprised of state banking regulators in the United States, brought the lawsuit challenging the OCC's decision to create a special-purpose national bank charter for fintech firms and other nonbank companies. The CSBS argues that state regulators have been successfully overseeing and regulating nonbank companies – including fintechs – for many years. State regulations require certain companies to meet safety and soundness requirements and to conform to both state and federal consumer-protection and anti-money-laundering laws. The CSBS alleges in its lawsuit that the OCC's fintech charter would displace those already effective state laws and create significant preemption issues.

The state bank regulators also allege that the OCC lacks the authority granted to it by Congress under the National Banking Act and other federal banking laws to create a national bank charter for nonbanking companies like fintechs. Those laws authorize the OCC only to charter institutions to carry on either the "business of banking" or certain special purposes expressly authorized by Congress, according to the state bank regulators. The state bank regulators argue that the OCC lacks authority to issue to fintech charters because fintechs do not engage in deposit-taking and do not engage in the "business of banking."

Finally, the state banking regulators allege that the OCC failed to follow the proper notice and comment procedures as required by the Administrative Procedures Act, instead

opting to publish a "high-level white paper and a supplement to the Comptroller's Licensing Manual and seeking public 'feedback' regarding the mechanics of its new charter." The state bankers note that the OCC has indicated that it will determine which federal banking laws will be applied to each charter holder and will incorporate those laws through private operating agreements individualized to the business model of each applicant. According to the state bankers, "the OCC's failure to follow proper rulemaking procedures in effecting such a fundamental change in national bank regulatory policy [violates the Administrative Procedures Act]."

From an industry perspective, the OCC has publicly stated that the bar for obtaining a charter will be quite high, and it expects only a handful of fintech firms to obtain a charter. Accordingly, small- to medium-sized fintech entities may decline to obtain a charter from the OCC.

In January 2017, the TPPPA responded to the OCC's Request for Comment on the fintech charter. The TPPPA indicated in its comment letter that the fintech charter could provide "clarity of the rules," to an otherwise murky regulatory landscape. The TPPPA wrote that "no federal regulator directly supervises payment processors and there is not a body of federal law that is particular to payment processors. … Rather, payment processors have had to deal with federal rulemaking through enforcement and inconsistent state laws. Given that there is little to no uniformity with respect to the state laws that apply to payment processors and money transmitters, these companies have encountered problems trying to comply with the inconsistent state laws." The TPPPA concluded that "if payment processors and money transmitters are allowed to operate under a national bank charter, these companies will have more clarity on the uniform set of laws that they must follow instead of trying to follow the different and sometimes inconsistent state laws."

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CFPB Files Suit Against Four Online Lenders Operated by Native American Tribe

By Keith J. Barnett, C. Reade Jacob, Jr. and Maryia Y. Jones

On April 27, the Consumer Financial Protection Bureau filed a lawsuit in an Illinois federal court against four online installment loan companies operated by a California Native American tribe. Although the tribe operates the installment loan companies, the CFPB's complaint alleges that the defendants are not "arms of the tribe" and therefore should not be able to share the tribe's sovereignty. The Bureau made these allegations in support of its belief that the defendants violated the Consumer Financial Protection Act ("CFPA") by entering into loan agreements that violated state usury and lender licensing laws. The Bureau alleged that the loans are void and cannot be collected under the CFPA because the loans are usurious under state laws. The complaint also alleges that the defendants violated the Truth in Lending Act ("TILA") by failing to disclose the cost of obtaining the loans.

All four defendants extend small-dollar installment loans through their websites. The Bureau's complaint alleges that the defendants' customers were required to pay a "service fee" (often $30 for every $100 of principal outstanding) and five percent of the original principal for each installment payment. As a result, the effective annual percentage rates of the loans ranged from approximately 440% to 950%. The complaint also alleges that each of the defendants' websites advertises the cost of installment loans and includes a rate of finance charge but does not disclose the annual percentage

rates. The defendants made the loans at issue in Arizona, Arkansas, Colorado, Connecticut, Illinois, Indiana, Kentucky, Massachusetts, Minnesota, Montana, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, and South Dakota.

During an investigation before the lawsuit was filed, the defendants claimed that they were entitled to tribal sovereign immunity because they acted as an "arm of the tribe." The CFPB's complaint disputes that defendants are entitled to tribal sovereign immunity because they allegedly do not truly operate on tribal land, that most of their operations are conducted out of Kansas (although the tribal members were in California), and that they received funding from other companies that were not initially owned or incorporated by the tribe.

The relief requested by the CFPB includes a permanent injunction against the defendants from committing future violations of the CFPA, TILA, or any other provision of "federal consumer financial law," as well as damages to redress injury to consumers, including restitution and refunds of monies paid and disgorgement of ill-gotten profits.

Lenders affiliated with Native American tribes have been subject to both regulatory and private lawsuits for violations of consumer protection laws, as we previously reported here and here. Recently, in January 2017, the Ninth Circuit Court of Appeals rejected the sovereign immunity arguments that tribal lenders made and affirmed a lower court's decision that three tribal lending companies were required to comply with the Bureau's civil investigative demands for documents. The Ninth Circuit stated that generally applicable federal laws, like the Consumer Financial Protection Act, apply to Native American tribes unless Congress expressly provides otherwise and Congress did not expressly exclude the three tribal lending companies from the Bureau's enforcement authority.

Chipotle Discloses Data Security Breach Related to Network Supporting Payment Processing for Restaurant

By Keith J. Barnett, Ashley L. Taylor, Jr., and C. Reade Jacob, Jr.

In its Form 10-Q dated April 25, 2017 for the quarterly period that ended on March 31, 2017, Chipotle Mexican Grill, Inc. announced that it had detected a data security breach in its electronic processing and transmission of confidential customer and employee information. Specifically, Chipotle's information security team detected unauthorized activity on the network that supports payment processing for its restaurants in April 2017. Chipotle reported that it immediately began an investigation with the help of leading computer security firms, and self-reported the issue to payment card processors and law enforcement agencies. Chipotle stated that its investigation, which is ongoing, is focused on card transactions at its restaurants that occurred from March 24 through April 18, 2017.

Chipotle stated that 70% of its sales in 2016 were attributable to credit and debit card transactions – meaning that the extent of the breach could be quite large. Chipotle also stated that it plans to provide notification to affected customers once it obtains more details about "the specific timeframes and restaurant locations that may have been affected."

Chipotle disclosed that as a result of the breach, the company could be "subject to lawsuits or other proceedings in the future relating to this incident or any future incidents in which payment card data may have been compromised. Proceedings related to theft of credit or debit card information may be brought by payment card providers, banks and credit unions that issue cards, cardholders (either individually or as part of a class action lawsuit), or federal and state regulators." Chipotle added that "any such proceedings could distract our management from running our business and cause us to incur significant unplanned losses and expenses."

In response to the breach, Chipotle noted that it has implemented additional security enhancements and "will continue to work vigilantly to pursue this matter to resolution."

Chipotle has set up a web page to provide updates on the breach, and it has recommended that consumers monitor their payment card statements and notify the bank that issued the card if they see unauthorized charges. Chipotle wrote on its web page that payment card network rules state that cardholders are not responsible for unauthorized charges.

CFPB Publishes Guide to Prepaid Card Rule, Delays Rule's Effective Date

By Brooke Conkle and Michael E. Lacy

At the end of January, the Consumer Financial Protection Bureau published its *Prepaid Rule – Small Entity Compliance Guide*. The Bureau intends for the Guide to provide a user-friendly summary of the Prepaid Rule, issued in October, but cautions that the Guide is not a substitute for reviewing the Rule, Regulation E, or Regulation Z. The new Guide complements the previously-released Prepaid Card Fact Sheet, published by the CFPB in November.

The Guide provides general definitions of applicable terms, such as "prepaid card," in addition to describing those entities subject to the Rule and offering examples that illustrate the new Rule in action. The Guide also gives considerable guidance on the numerous new disclosures required by the Rule, including pre-acquisition disclosures, disclosures on access devices, and initial disclosures. Notably, the Prepaid Rule requires financial institutions to provide customers with both a short form and a long form disclosure before opening a prepaid account. The Guide explains both of these disclosures and provides links to sample forms in fillable, .pdf versions.

The Prepaid Rule was originally scheduled to take effect on October 1, 2017. However, on March 9, the Bureau proposed delaying the effective date of the Rule by six months. According to the CFPB, members of the industry have expressed concern over complying with certain provisions of the new Rule by the October deadline. "While we are not proposing to change any other part of the prepaid accounts rule at this time, we are asking the public to provide comments about any implementation challenges that may affect consumers, and how additional time will impact the industry, consumers, and other stakeholders," the CFPB said in a statement.

On April 4, the American Bankers Association ("ABA") submitted commentary to the CFPB, welcoming the Bureau's proposal to delay the Rule's effective date. In the letter, however, the ABA also encouraged the CFPB to adopt a more objective definition of "prepaid account" as any product marketed or labeled as a prepaid account or card. "Absent a usable distinction, banks face unfair and significant compliance risk and liability for inadvertent violations if an examiner or plaintiffs' lawyer asserts that the bank's checking account should be treated as a prepaid account and subject to the related disclosures and restrictions of the rule," the ABA wrote. According to the ABA, ambiguity in the current definition could discourage banks from offering checkless checking accounts and prevent the development of other products to serve the unbanked.

These proposed changes may not be the final word on the Rule. As we reported previously, Republicans in both the House and Senate have proposed killing the Rule entirely and have offered bills that would submit the Rule to a vote of disapproval under the Congressional Review Act.

Multistate Coalition of AGs Calls on Congress to Support Consumer Protections for Prepaid Debit Cards

By Devika Persaud and Siran S. Faulders

A multistate coalition of attorneys general led by District of Columbia Attorney General Karl A. Racine is opposing three resolutions before Congress (S.J. Res. 19, H.J. Res. 62, and H.J. Res. 73) that would block a Consumer Financial Protection Bureau final rule intended to give users of prepaid cards some of the same protections given to users of traditional banking and credit products (the "Final Rule"). The Final Rule is currently scheduled to go into effect on April 1, 2018. On April 5, 2017, the coalition sent a letter to congressional leadership, urging opposition to resolutions that would block implementation of the rule.

The letter states that prepaid cards are a rapidly growing market and often used by consumers who have limited or

no access to a traditional bank account. It is becoming more common for consumers to receive wages or financial aid funds for student loans on prepaid cards. In fact, since 2015, more consumers have been receiving their wages by prepaid cards than by conventional paper checks. Consumers frequently report concerns to the CFPB about hidden or abusive fees associated with the prepaid cards and fraudulent transactions that deplete funds loaded onto them. Although prepaid cards are generally designed to avoid overdraft fees, some of the payday lenders who provide funds through these cards have been subjecting consumers to poorly disclosed or undisclosed overdraft fees.

The CFPB's Final Rule provides certain protections that are afforded to consumers for traditional financial products. Among the provisions intended to protect consumers, the Final Rule seeks to:

- Protect prepaid card users against fraud and unauthorized charges;
- Help consumers avoid hidden fees and encourage them to comparison shop with a simple chart of common fees;
- Provide convenient, free access to account transactions and account balances;
- Require employers to inform employees they do not have to receive wages on a prepaid card; and
- Require prepaid cards to comply with existing credit card laws (including an ability-to-pay analysis, limits on overdraft fees in the first year, and safeguards on how funds are repaid).

The resolutions to stop implementation of the CFPB's Final Rule have been filed under the Congressional Review Act ("CRA"), meaning that if the rule is blocked by a CRA vote, the CFPB is forever barred from enacting a substantially similar rule unless Congress authorizes it. Congress has recently revived the CRA as a way to block consumer protections put in place during the Obama administration.

In addition to the District of Columbia, the states signing on to the letter include California, Hawaii, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Mississippi, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, and Washington.

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