

CLIENT UPDATE

N.Y. DEPARTMENT OF FINANCIAL SERVICES BEGINS TO FLEX DODD-FRANK MUSCLES

NEW YORK

Eric R. Dinallo
edinallo@debevoise.com

Philip A. Fortino
pafortino@debevoise.com

Liz Alspector
lalspect@debevoise.com

Noelle E. Lyle
nelyle@debevoise.com

WASHINGTON, DC

David Luigs
daluigs@debevoise.com

On April 23, the New York State Department of Financial Services (“DFS”) filed the first lawsuit by a state financial regulator to enforce the consumer financial protection provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act” or the “Act”). Under the Act, state attorneys general and state regulators (collectively, “state officials”) have certain concurrent authority with the Consumer Financial Protection Bureau (“CFPB”) to bring actions to enforce Title X of the Act, as well as CFPB regulations promulgated thereunder. The DFS action comes on the heels of the first Dodd-Frank enforcement action filed by a state attorney general just last month. These two actions—both brought to enforce the Title X’s prohibition on unfair, deceptive or abusive acts or practices (“UDAAPs”)—may foreshadow a new enforcement trend with important consequences for covered organizations.

SECTION 1042 OF THE DODD-FRANK ACT

Section 1042 of the Dodd-Frank Act, codified at 12 U.S.C. § 5552, permits both state attorneys general and state regulators to bring actions to enforce the provisions of Title X of the Act, as well as the regulations promulgated thereunder. Such enforcement actions may be filed in any United States district court within the state or in a state court with jurisdiction over the defendant.¹ The authority

¹ 12 U.S.C. § 5552(a)(1).

vested in the state attorneys general and state regulators differs only insofar as actions by state regulators may only be brought against organizations that are chartered, incorporated, licensed or otherwise authorized to do business under state law.²

Although, generally speaking, the Act's grant of enforcement authority to state attorneys general is rather broad, their ability to proceed against certain federally chartered depository institutions is limited. State attorneys general cannot bring actions against a national bank or Federal savings association to enforce a provision of Title X of the Dodd-Frank Act.³ They may, however, bring actions against such organizations to enforce regulations promulgated under that title and to secure remedies provided for there.⁴

At least ten days prior to bringing an enforcement action, the state official planning to bring the action must provide a copy of the complaint and written notice of the action to the CFPB. The state attorney general or regulator also must provide notice to the prudential regulator of the defendant, if any.⁵ If prior notice is not practicable, the state must provide notice and a copy of the complaint when the action is filed.⁶ The CFPB cannot prevent a state enforcement action from proceeding, but it has the option to intervene in the action and, upon intervention, is guaranteed the right to "be heard on all matters arising in the action."⁷ The CFPB also has the power to appeal any order or judgment to the same extent as a party to the enforcement action.⁸

ENFORCEMENT ACTIONS TO DATE

To date, only two state enforcement actions have been filed under Section 1042. Both actions have been brought under Section 1036 of the Act, which makes it unlawful for those offering consumer financial products or services to engage in UDAAPs.⁹

The most recent state enforcement action, filed by DFS on April 23, 2014, alleges that Condor Capital Corporation, a servicer of subprime auto loans, violated Dodd-Frank's prohibitions on UDAAPs. Specifically, the complaint asserts that Condor adopted a policy of refusing to refund overpayments by borrowers and that it took steps to conceal the

² *Id.*

³ 12 U.S.C. § 5552(a)(2)(A).

⁴ 12 U.S.C. § 5552(a)(2)(B).

⁵ 12 U.S.C. § 5552(b)(1)(A); 12 C.F.R. § 1082.1.

⁶ 12 U.S.C. § 5552(b)(1)(B).

⁷ 12 U.S.C. § 5552(b)(2).

⁸ 12 U.S.C. § 5552(b)(2)(C).

⁹ 12 U.S.C. § 5536(a).

existence of positive balances from both borrowers and the state. The complaint further alleges that Condor falsely assured consumers that it could adequately protect their personal information, though it had not implemented reasonable and appropriate security measures. In addition to these federal claims, the complaint also alleges violations of the state Financial Services Law and Banking Law. DFS has obtained a temporary restraining order against Condor.

The first state enforcement action, filed by the Illinois attorney general on March 18, 2014, alleged that CMK Investments, Inc., a payday loan provider, violated Illinois consumer fraud laws and Dodd-Frank's prohibitions on UDAAPs by charging borrowers a recurring "account protection fee." According to the complaint, CMK led borrowers to believe that the fee was a mandatory insurance product, when in fact it did little to protect borrowers and instead functioned as additional interest. Illinois has capped annual interest rates on most payday loans at 36%, but with the fee included, CMK charged borrowers up to 500%. This action is pending in the Cook County Circuit Court.

IMPLICATIONS

The rapid-fire, one-two punch of the first attorney general and financial regulator actions under section 1042 may have serious implications for companies covered by the Dodd-Frank Act:

- The filing of the first state enforcement actions establishes the threat of a Dodd-Frank consumer finance enforcement action as a credible one. Although the actions actually filed are based on potentially criminal conduct that seemingly would qualify as UDAAPs under anyone's definition, the credible threat of an enforcement action could be used to procure settlements in more borderline cases.
- To the extent that a proliferation of state enforcement actions arise, there is a risk that a hodgepodge of federal and state courts may construe the prohibition on UDAAP in inconsistent ways, causing uncertainty for organizations that operate nationwide as to the standard to which they must adhere. The CFPB's ability to intervene in these actions, the operation of the Supremacy Clause and the federal appellate process all will mitigate confusion over time, but it could take years before the meaning of the provision is authoritatively articulated.
- By pursuing relief under Title X of Dodd-Frank, state officials can bring enforcement actions directly in federal court, which provides them with certain advantages in connection with discovery (e.g., nationwide service of process). Moreover, the type of

relief available under the Title X may be more expansive than under the typical state analog, including with respect to the amount of civil penalties available.

- The state's use of the Dodd-Frank Act necessarily will, in a certain proportion of cases, result in concurrent action by the CFPB or another federal regulator. This phenomenon could have the effect of exponentially increasing the cost of resolution insofar as the CFPB has much broader jurisdiction than the state officials.
- Given the novelty of and current political interest in the Dodd-Frank Act, any state enforcement actions filed under Title X are likely to lead to greater publicity than if the same action were brought under state consumer protection statutes.

* * *

April 25, 2014