States Fulfill Their Promise of More Regulatory Oversight of Consumer Financial Services: What Industry Needs to Know

By Ann E. Lemmo, Joann Needleman / Jan 17, 2020

Both the departure of Richard Cordray at the Consumer Financial Protection Bureau (CFPB) and the Trump Administration's priority to ease regulatory burden spurred speculation that the states would fill the void as the consumer financial services' watchdog. In March 2018, then acting Director of the CFPB Mick Mulvaney told a gathering of states' attorneys general that "States know best how to protect their own consumers."[i] States now have been taking that directive to task. Since the fall of 2017, states like Pennsylvania, New Jersey, and Maryland revamped divisions of Attorneys General offices or reshuffled state regulators' offices to focus solely on consumer financial protection. However, with this week's much-publicized announcements by the Governors of New York and California that their respective regulators are ready to get down to business, the threat of state oversight of financial services institutions is now a reality.

In the case of New York, the announcement was quite puzzling since, in April of last year, the Department of Financial Services (DFS) merged their Enforcement Division with the Financial Frauds and Consumer Protection Division to create the Consumer Protection and Financial Enforcement Division. Since its inception in 2011, DFS was always an aggressive financial services regulator. In June 2019, Linda Lacewell was confirmed by the New York state senate as Superintendent of DFS. A press release announcing her confirmation noted that in her first 100 days as Acting Superintendent, Lacewell took comprehensive steps to protect consumers "at a time when Washington was dismantling vital consumer protections."[ii] Recently, DFS hired Leandra English as a special policy advisor, who for a short time claimed to be Richard Cordray's successor. Ms. English recently penned an article with the New York Daily News where she confirmed that Governor Cuomo's proposals would further establish New York as the "consumer protection capital of the nation." [iii] Ms. English also stated in her op-ed that the "use of aggressive debt collection tactics is on the rise." This unfortunately conflicts with the CFPB's data which shows approximately 46,000 debt collection complaints in 2019 down from approximately 81,000 complaints in 2018.[iv]

In May 2019, Manny Alverez, a former CFPB enforcement attorney, was named the new commissioner for the California Department of Business Oversight (DBO). Governor Newsome's proposals include renaming DBO to the Department of Financial Protection and Innovation ("DFPI"), which would regulate similar markets that were also under the CFPB's jurisdiction. The Governor is looking to add ninety positions to the DFPI with sixteen of those positions devoted exclusively to enforcement. DFPI will also focus on financial innovation to "cultivate the responsible development of new consumer financial products."[v] Although little detail has been revealed about what such an office might look like, it will probably not look like the CFPB's current sandbox. California's Attorney General, Xavier Becerra, strongly opposed the sandbox, calling it "a free pass to avoid the law."[vi]

For the consumer financial services industry, compliance consistency has been critical to ensuring that operations run smoothly and that regulatory expectations are met. The cost of compliance for financial services firms grew exponentially in the last decade and that infrastructure will not be abandoned. However, the announcements by the two largest states in the country suggest not only additional resources will need to be put into place, but industry will need to adjust for the varying degrees of policies and procedures to meet each state's respective requirements. This will be complicated and costly for those financial services firms that have a national footprint.

Whatever the details of the new legislation or regulation in California or New York, as well as other states, industry should consider and pay attention to the following:

Licensing

Whatever financial product or service you deliver to consumers, if you were not licensed before, you will more than likely be licensed in the future. While licensing fees varying from state to state, requirements for licensing can be onerous including the posting of a surety bond, criminal background checks, and on-going reporting and auditing. More importantly, licensing is an invitation to have regulators knocking at your door without any advanced warning and sometimes without justification.

State Consumer Protection Laws can have a Broader Scope than Federal Law

While many consumer financial services providers may comply with federal law, state laws may have a broader scope. For example, in several states, debt collection laws can apply to creditors, who are specifically exempt under federal law. In the student loan servicing space, many states have enacted laws that impose legal requirements well beyond what the federal law requires, including licensing and requiring servicers to evaluate a borrower's eligibility for certain income repayment plans.

Fair Lending

From Congress to local consumer advocates, much criticism has been directed at the CFPB for failing to bring any fair lending enforcement actions. States and even cities like Philadelphia and Miami have been active in going after financial institutions for redlining and discriminatory lending practices. Expect these new mini-CFPBs to coordinate with state attorneys general in picking up on the CFPB's very aggressive enforcement from several years ago.

Unfair, Deceptive and Abusive Acts and Practices (UDAAP)

Both California and New York have indicated that they will pursue unfair, deceptive, and abusive acts and practices. Dodd-Frank granted the CFPB authority to pursue abusive conduct but did not otherwise define the term. Borrowing from the CFPB's enforcement playbook, UDAAP interpretation is entirely subjective and dependent on the enforcement attorney's interpretation at the time. What wasn't considered abusive today could run afoul of UDAAP tomorrow. Such a lack of clarity can result in a compliance nightmare of uncertainty.

Now maybe a good time to refresh yourself on the various state laws that impact the products or services you sell in a particular state, to set aside additional resources for increased costs for licensing and to engage in assessment or readiness audits should a regulator "come-a-knocking."

Welcome to the disruption and Happy New Year!!!

[i] Remarks delivered at the winter meeting of the National Association of Attorneys General ("NAAG") on February 28, 2018.

[ii]New York State Department of Financial Services Press Release of June 21, 2019, available at https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1906211.

[iii] Leandra English, The Fight to Protect Consumers, at a Crossroads, (Jan. 14, 2020) https://www.nydailynews.com/opinion/ny-oped-the-fight-to-protect-consumers-20200114-dd7juswygvgdxo4buwtqwvdf54-story.html.

[iv] Bureau of Consumer Financial Protection, Consumer Response Annual Report, January 1- December 31, 2018, available at https://files.consumerfinance.gov/f/documents/cfpb_consumer-response-annual-report_2018.pdf.

[v] Gavin Newsom, Governor's Budget Summary 2020-21, 174 (Jan. 10, 2020) available at http://www.ebudget.ca.gov/FullBudgetSummary.pdf.

[vi] Press Release, California Dep't Justice, Attorney General Becerra Opposes CFPB Proposal to Exempt Companies from Oversight (Feb. 12, 2019) available at https://oag.ca.gov/news/press-releases/attorney-general-becerra-opposes-cfpb-proposal-exempt-companies-oversight.