Chapman and Cutler LLP

To the Point!

legal, operations, and strategy briefs for financial institutions May 8, 2015

U.S. Supreme Court Will Not Hear *CashCall* Case – Uncertainty for Marketplace Lenders?

On May 4, 2015, the U.S. Supreme Court denied the petition for a writ of certiorari for *CashCall v. Morrissey*. *CashCall* is a case from West Virginia involving an internet loan program operator, CashCall, Inc., that marketed loans to consumers in West Virginia, which loans were funded by a South Dakota FDIC-insured bank. This type of arrangement is sometimes referred to as "rent-a-bank," where a regulated bank funds loans that are offered by a third party who provides origination and related services and usually purchases the loans shortly after funding. The West Virginia Attorney General filed suit against CashCall on the theory that CashCall was actually the true lender having the predominant economic interest under this arrangement and was using the bank to circumvent applicable state law lending requirements. CashCall was not a licensed lender under West Virginia law and the loans funded by the bank were made at interest rates in excess of the state's usury rate. The Attorney General also alleged that CashCall was engaging in abusive debt collections with respect to these loans.

In 2012, a lower court found that CashCall had the predominant economic interest in the loans and thus was required to abide by West Virginia's licensing and usury laws. The court enjoined CashCall from making new loans in West Virginia, voided the existing loans, thereby cancelling the debt of the borrowers, and awarded $1.5 million in civil penalties and $10 million in punitive damages against CashCall in addition to attorneys' fees and costs, for a total judgment of $13.8 million. This judgment was upheld by the West Virginia Supreme Court of Appeals in 2014.

CashCall filed a petition for a writ of certiorari with the U.S. Supreme Court seeking review of the state court's decision that it was bound by state interest rate limits on loans made by an FDIC-insured bank to West Virginia consumers. Many in the marketplace lending industry were hoping the Supreme Court would hear the case and provide guidance as to whether relationships involving a funding bank are valid since these arrangements are becoming increasingly common in internet lending programs. Without guidance from the Supreme Court, uncertainty will remain as to whether such arrangements are permissible, and there is the potential for increased scrutiny by state regulators and other stakeholders. Entities that participate in such arrangements, either as the funding bank or as the program operator, should be aware that these unresolved questions could lead to further litigation surrounding the "true lender" issue and the use of funding banks in these types of programs, and they should use care in structuring such relationships. More broadly, the predominant economic interest theory raised by the West Virginia courts could possibly impact other sales of loans or securitizations made soon after loan consummation.

FinCEN Current Priorities

FinCEN Director Jennifer Shasky Calvery recently spoke at the West Coast Anti-Money Laundering Forum, providing insight into current priorities at the agency. The Director discussed FinCEN's efforts to ensure compliance with money services business requirements by virtual currency exchanges and administrators, including recent supervisory examinations of these entities conducted by the Internal Revenue Service and FinCEN BSA examiners.

Additionally, the Director addressed the status of its Notice of Proposed Rulemaking on due diligence requirements regarding the beneficial ownership of accounts, which closed for comment in October 2014. She noted that the agency believes a rule would clarify and strengthen financial institution customer due diligence responsibilities and would provide the agency with important information derived from enhanced financial transparency. She specifically cited money laundering through purchase of real estate and third-party money launderers such as attorneys and accountants, which may be used by criminal organizations to gain access to the financial system, as practices

that would be affected by the proposed enhanced due diligence requirements. She concluded her comments by stating that the agency was in the process of reviewing the 126 comments received from trade associations, law firms, consulting firms, research institutes, banks and other financial institutions, without providing a time frame for issuance of a final rule.

Although it does not appear that a beneficial ownership rule will be issued by FinCEN soon, financial institutions should remain mindful of their current obligation to adopt risk-based due diligence programs that may in certain circumstances require verification of the beneficial ownership of companies they service today.

Guidance on Youth Savings Programs

The bank regulatory agencies together with FinCEN issued "Guidance to Encourage Financial Institutions' Youth Savings Programs and Address Related Frequently Asked Questions" (the *"Guidance"*) to clarify for financial institutions the application of legal and regulatory requirements to youth savings program accounts. The Guidance encourages financial institutions to collaborate with schools, local and state governments, non-profits and others to offer safe, low-cost savings accounts and financial educational programs to youths to help them learn how to develop good savings habits and manage money effectively.

The Guidance addresses issues such as opening an account for a minor, customer identification program requirements, and agency-specific branching requirements that may apply. Financial institutions were reminded that all federal and state consumer financial protection laws and regulations apply to youth savings accounts, including the Truth in Savings Act, the Expedited Funds Availability Act, the Electronic Fund Transfer Act and prohibitions against unfair or deceptive acts or practices. The Guidance concluded that banks could not provide ATM or debit cards to minors for Uniform Transfers to Minors Act (*"UTMA"*) or Uniform Gifts to Minors Act (*"UGMA"*) accounts because a minor cannot withdraw funds without the custodian's approval.

Financial institutions with youth savings programs should review their programs to ensure that they comply with the Guidance, and they should consider whether steps are needed to revise their youth savings programs to conform to the Guidance. Financial institutions should also review their practices regarding issuance of ATM and debit cards to minors to ensure that they adhere to the prohibition regarding UTMA and UGMA accounts.

Overdraft Update – CFPB Enforcement Action

On April 28, 2015, the CFPB took its first enforcement action under Regulation E, which prohibits a bank from charging overdraft fees to consumers who did not opt in to overdraft coverage for ATM and one-time debit card transactions. According to the consent order, the CFPB found: (i) the bank failed to stop charging overdraft fees after it discovered in 2012 that overdraft fees were being charged to customers who had not opted in; and (ii) the bank's materials for its deposit advance product were deceptive because they erroneously represented that an overdraft fee would not be charged if payment from a customer's checking account caused the balance to become negative. The CFPB assessed $7.5 million in penalties and required refunds to all affected customers, along with corrections of credit reports. The CFPB noted in its announcement of the enforcement action that the penalties would have been higher had the bank not refunded customers and promptly self-reported the issues to the CFPB under the agency's Responsible Conduct Bulletin issued in 2013. On the same day, the CFPB also issued a consumer advisory on overdraft issues.

Although this was the first enforcement action under Regulation E's rule that prohibits overdraft fees without an opt in, the CFPB remains fairly active in the overdrafts area. The CFPB released a report in July 2014 related to its June 2013 white paper on overdraft practices. The July 2014 report noted that debit card users were almost three times more likely to incur an overdraft than consumers writing checks or paying bills online and that the average transaction causing an overdraft was only $24. CFPB Director Richard Cordray stated that the July 2014 report showed that consumers who opt in to overdraft coverage put themselves at serious risk when using their debit cards, as overdrafts continue to impose heavy costs on consumers with low account balances. More recently, in March 2015, the CFPB revealed in its Winter 2015 Supervisory Highlights that violations involving overdraft practices discovered by the CFPB continue to be addressed through non-public supervisory

actions. Finally, the CFPB's Fall 2014 regulatory agenda indicated that the CFPB was considering possible rulemaking that may include disclosures or address specific acts or practices related to overdrafts. More is expected to come from the CFPB regarding overdrafts and updates to its possible rulemaking activities.

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®

To the Point! is a summary of items of interest and current issues for financial institutions with primary focus on regulatory, consumer, and corporate issues. Chapman maintains a dedicated practice group with the experience to counsel on these issues and other enterprise risk management matters facing financial institutions. If you would like to discuss any of the items contained in these briefings or other legal, regulatory, or compliance issues facing your institution, please contact one of the members of our Bank Regulatory Group:

Marc Franson • 312.845.2988
Heather Hansche • 312.845.3714
John Martin • 312.845.3474
Judy Chen • 312.845.3716
Scott Fryzel • 312.845.3784
Doug Hoffman • 312.845.3794
Dianne Rist • 312.845.3404
Lindsay Henry • 312.845.3869