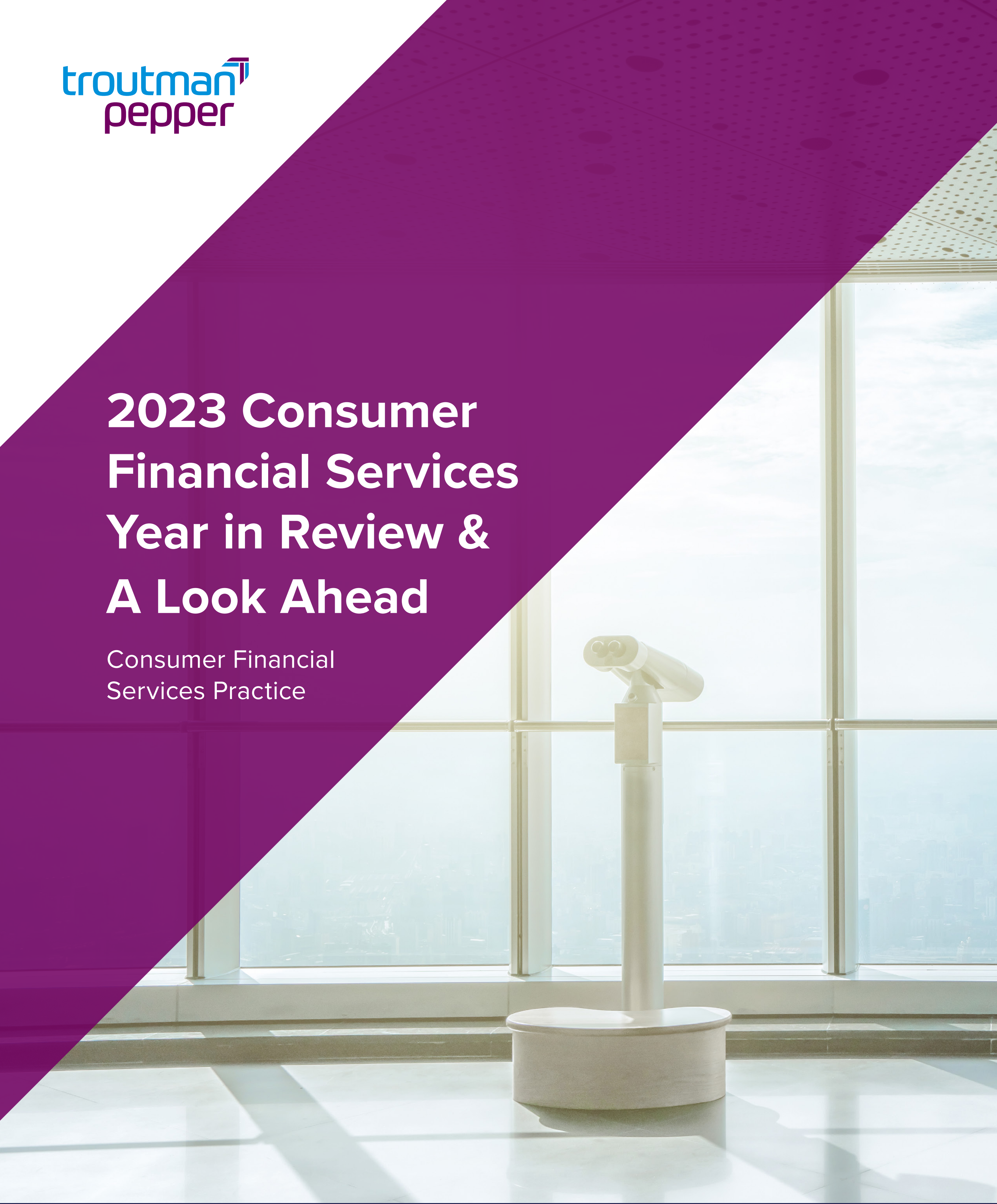


2023 Consumer Financial Services Year in Review & A Look Ahead

Consumer Financial Services Practice

2023 Consumer Financial Services Year in Review & A Look Ahead

Table of Contents

The views and opinions expressed in these materials are solely those of the authors. While these materials are intended to provide accurate information regarding the subject matter covered, they are designed for educational and informative purposes only. Nothing contained herein is to be construed as the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. Use of these materials does not create an attorney-client relationship between the user and the authors.

EXECUTIVE SUMMARY

We are pleased to present our eighth edition of the *Consumer Financial Services Year in Review & A Look Ahead*. Our goal, in this publication and in every aspect of our work, is to help you understand and tackle today's issues while preparing you for what lies ahead. We are honored that you rely on us to assist you with your challenges and concerns.

With active federal and state legislatures, consumer financial services providers faced a challenging 2023. Courts across the country issued rulings that will have immediate and lasting impacts on the industry. Our Consumer Financial Services Practice Group helped clients navigate large volumes of industry regulations, find successful resolutions, and stay ahead of the compliance curve. That work informed this *Year in Review*, which was written with the goal of producing a helpful resource for you throughout the coming year.

In this compendium, we share developments on auto finance, background screening, bankruptcy, consumer class actions, consumer credit reporting, cryptocurrency, debt collection, fair lending, fintech, mortgage, payment processing and cards, privacy, small dollar lending, student lending, the Telephone Consumer Protection Act, tribal lending, and the Uniform Commercial Code and banking. We hope you find our report insightful and valuable for your business strategy, so that you can focus less on the law and more on achieving your business goals.

I would appreciate your feedback on this year's publication. Please feel free to contact me at any time at michael.lacy@troutman.com with any questions, comments, or suggestions.

Michael Lacy, Practice Group Leader

ABOUT OUR PRACTICE

Troutman Pepper's Consumer Financial Services Practice Group provides comprehensive guidance to clients across the financial services sector. With more than 140 attorneys and professionals nationwide, our litigation, regulatory enforcement, and compliance teams bring industry-specific knowledge and practical advice throughout the business life cycle. Our results-oriented approach proactively mitigates risk, enabling our clients to focus on their business objectives.

Our national litigation team handles leading-edge and groundbreaking issues that often have industry-wide implications. We have resolved thousands of individual and class-action lawsuits involving every federal and state consumer protection statute, including the:

- Fair Credit Reporting Act (FCRA)
- Fair Debt Collection Practices Act (FDCPA)
- Telephone Consumer Protection Act (TCPA)
- Truth in Lending Act (TILA)
- Real Estate Settlement Procedures Act (RESPA)
- West Virginia Consumer Credit Protection Act (WVCCPA)
- Unfair and Deceptive Acts and Practices (UDAP)
- Unfair, Deceptive, and Abusive Acts and Practices (UDAAP)
- Electronic Funds Transfer Act (EFTA)
- Electronic Signatures in Global and National Commerce Act (E-SIGN)
- Equal Credit Opportunity Act (ECOA) and state law equivalent statutes
- Fair and Accurate Credit Transactions Act (FACTA)
- Home Affordable Modification Program (HAMP)
- Home Ownership and Equity Protection Act (HOEPA)
- Servicemembers Civil Relief Act (SCRA)
- Magnuson-Moss Warranty Act
- Federal and state odometer acts
- Federal Trade Commission (FTC) Holder Rule
- Home warranties
- Mortgage foreclosures
- Mortgage lending and servicing
- Cybersecurity and privacy
- State law debt collection claims

Our team's litigation experience and insights contribute to our best-in-class approach to compliance and regulatory services. Our regulatory enforcement team has a long track record of handling the Consumer Financial Protection Bureau's (CFPB) oversight inquiries, civil investigative demands (CIDs), audits, supervision, examinations, and enforcement actions, including requests for the production of privileged and highly confidential information routinely demanded by the CFPB to assess compliance and procedures. Our enforcement team has years of experience handling similar matters as well as CID, audit, supervision, examination, and enforcement proceedings. We also are well equipped to handle FTC investigations concerning a variety of matters, including consumer privacy and data security breaches. When necessary, our team moves seamlessly from negotiation to litigation, utilizing highly skilled litigators with exceptional depth in regulatory enforcement litigation matters.

Our approach to compliance helps clients avoid costly government audits, investigations, fines, litigation, and damage to their brands and reputations. Our clients rely on us to address a variety of matters, including facilitating compliance audits (both on-site and off-site), performing due diligence reviews, drafting training and compliance manuals and policies, and conducting multistate analyses of state and federal laws.

Our team publishes a variety of resources to help clients remain knowledgeable and stay ahead of consumer finance law. Please refer to page 45 for information on our blog, *The Consumer Financial Services Law Monitor*; our weekly and monthly podcasts; and our webinar offerings. You will also find a link to sign up for notifications and the content you wish to receive.

AUTO FINANCE

Contributors: Brooke Conkle, Chris Capurso, Jonathan DeMars, Stephen Steinlight

In 2023, the major stories for auto finance saw federal and state regulators continue to pursue initiatives on hot-button topics, including fair lending and add-on products such as guaranteed automobile protection (GAP) products. In January, Colorado Attorney General Phil Weiser announced that his office had reached settlements with Bellco and Canvas credit unions, which agreed to provide $4 million in refunds of unearned GAP premiums to consumers that the credit unions failed to provide previously. As part of those settlements, the credit unions stipulated that going forward GAP refunds will be made on all consumer loans prepaid before maturity.

On February 23, the CFPB announced orders to nine of the largest auto lenders requesting information about their auto lending portfolios. According to the CFPB, the data collected will help the CFPB build a dataset that provides insight into lending channels and loan performance. In particular, the CFPB identified three areas where it believes the requested data will increase visibility into the market:

- **Lending Channels:** The data requests require lenders to identify whether each loan is direct or indirect.
- **Data:** According to the CFPB, thorough auto lending analyses are "nearly impossible" due to variations in existing data and the difficulty in creating a comprehensive dataset from existing sources.
- **Repossessions:** Specifically, the CFPB requests information on the circumstances leading up to a repossession, and the impact of a repossession on the borrower and lender. The Bureau indicated it is interested in the potential correlation between delinquency and geography, credit score, and income.

The CFPB issued these requests under its authority to monitor the auto finance market under 12 U.S.C. § 5511(c)(3) and not as a supervisory order or civil investigative demand. However, the CFPB expressly reserved the right to use the information gathered for any purpose permitted by law. These requests indicate that auto finance will remain a front-and-center area of interest for the CFPB.

On March 20, Indiana Attorney General Todd Rokita and the Indiana Department of Financial Institutions announced a settlement in excess of $250,000 with Integrity Acceptance Corp., affiliated companies, and their owners to resolve allegations that they originated personal loans without a license, contracted for charges in excess of the maximum allowable rate, misrepresented finance charges, and failed to disclose prepaid finance charges in violation of the Indiana Uniform Consumer Credit Code and Indiana Deceptive Consumer Sales Act. As part of the settlement, the entities agreed to forgive $223,685 in loans, pay $33,991 in restitution, and pay $33,000 in civil penalties and costs to the state. Notably, Indiana chose to pursue the entities under Indiana law rather than asserting violations of potentially applicable federal statutes like the Consumer Financial Protection Act or the Truth in Lending Act.

During the summer of 2023, the CFPB issued its *Supervisory Highlights Report*, providing an overview of alleged UDAAP identified by the agency. Included in the report for the first time was the finding related to powerbooking in the indirect auto industry, representing the CFPB's effort to impose an unprecedented duty on auto finance companies to make adjustments to a principal balance based on the existence of a misrepresentation made by the dealer to the lender about the vehicle. The list of what CFPB considered the most significant compliance issues for auto lending/servicing included, "Dealers fraudulently documented options that were not actually present on the vehicle — sometimes called 'powerbooking.' In the instances where these discrepancies were identified, loan servicers did not reduce the amount the consumers owed on the loan." This provided a major, unprecedented expectation from the CFPB related to powerbooking, with an ambiguous legal

basis, and which could be very significant for auto finance companies.

In July, the Board of Governors of the Federal Reserve System (Federal Reserve) issued a survey that addressed changes in the standards and terms on, and demand for, bank loans to businesses and households in the second quarter of 2023. Specifically focusing on auto loans, the Federal Reserve reported, among other things:

- Demand weakened for auto loans generally;
- A significant and moderate net share of banks reported that standards on prime auto loans were on the tighter end of their ranges; and
- A significant net share of banks reported expecting to tighten standards on auto loans for the remainder of the year.

Also in July, Rhode Island's attorney general announced a roughly $550,000 settlement with three car dealerships to resolve allegations that the dealerships:

- Charged more for vehicles than advertised on their websites;
- Automatically charged every customer a $249 paint and fabric spray fee; and
- Described vehicles as available for "auction" or "wholesale" prices in violation of the Rhode Island Deceptive Trade Practices Act.

Notably, while Rhode Island chose to pursue the entities under state law rather than asserting violations of potentially applicable federal statutes, the attorney general echoed the agenda of federal regulators targeting purported "junk fees."

In October, the FTC and the Wisconsin Department of Justice announced a settlement with a Wisconsin auto dealer group. The lawsuit was brought under the FTC Act, the Equal Credit Opportunity Act (ECOA), the Wisconsin Deceptive Trade Practices Act, and the Wisconsin Consumer Act. The complaint alleged that the dealer group (a) charged for "add-on" products or services without consumers' consent, and (b) unlawfully discriminated against American Indian customers by imposing higher borrowing costs relative to non-Latino White customers. On average, American Indian customers were charged approximately 34 basis points (approximately $401 per customer) more in interest rate markups than similarly situated non-Latino white customers. That disparity increased to 50 basis points on average following an ownership transfer.

As part of the settlement, the dealer group will pay $1 million in restitution to consumers. The settlement also requires the dealer group to establish a comprehensive fair lending program that will, among other things, allow consumers to seek outside financing and cap the additional markup the dealer group can charge consumers.

Looking Forward to 2024

We anticipate that federal regulators will continue to team up to further the CFPB's initiatives. This means that federal regulators' "war on fees" will continue to be felt in the auto finance space, namely through the recently enacted CARS Rule, which has a speedy compliance date of July 30, 2024. We will also look for regulators at the federal and state levels to continue to target discriminatory practices and violations at the point of sale, including proper disclosures and the sale of add-on products. With increased ambiguity surrounding the recovery of attorneys' fees under the Holder Rule, auto finance companies may want to consider increased review of dealer partners for regulatory compliance. ■

BACKGROUND SCREENING

Contributors: Cindy Hanson, Scott Kelly, Elizabeth Andrews, Noland Butler, Noah DiPasquale

Regulator Scrutiny of Background Screeners Intensifies in 2023

In 2023, the CFPB and the FTC intensified their focus on background screeners, with a particular focus on (1) the use of eviction records, algorithms, and artificial intelligence in tenant screening and (2) the procedures that allow consumers to dispute inaccuracies. Notably, in February 2023, the agencies coordinated a joint request for information regarding tenant screening.

The request sought public comment on a variety of issues affecting tenant background screening, including:

- How landlords and property managers set screening criteria;
- The collection and accuracy of criminal and eviction records for tenant screening; and
- The use of algorithms for matching or predictive purposes.

These requests demonstrated a particular focus on the agencies' goals to prevent discrimination and empower consumers to dispute inaccuracies. Over 1,700 public comments were received, which can be reviewed here. The initial press release stated that these comments will be used to "help inform enforcement and policy actions under each agency's jurisdiction."

In October, the CFPB and FTC initiated a significant enforcement action settlement with TransUnion and its tenant screener subsidiary, TransUnion Rental Screening Solutions, Inc. (TURSS). The TransUnion and TURSS settlement resulted from allegations that the companies failed to ensure maximum possible accuracy of information in consumer reports and did not disclose the sources of such information to consumers. In addition to monetary terms, the settlement included significant injunctive relief components, including requiring TransUnion to implement procedures designed to:

- Prevent inclusion of unresolved eviction cases in tenant screening reports;
- Accurately reflect the disposition of eviction cases;
- Ensure sealed records are not reported;
- Disclose the sources of information to consumers; and
- Monitor and perform root cause analysis on consumer disputes to identify and correct issues with public record reporting.

The TransUnion settlement demonstrated specific subareas of concern for the agencies. The emphasis on additional procedures to ensure accuracy of eviction record reporting is particularly noteworthy.

The CFPB Updated Certain Required FCRA and ECOA Disclosures in 2023, With a Mandatory Compliance Date of March 20, 2024

Consistent with the CFPB's increased attention on background screening, the agency issued a final rule that updated the model form for the FCRA Summary of Consumer Rights and information that must be included in adverse action notices under the ECOA.

The Summary of Consumer Rights (Summary) explains certain consumer rights available under the FCRA. Consumer reporting agencies (CRAs) must provide a copy of the Summary (a) with each written disclosure from the CRA to a consumer (15 U.S.C. § 1681g(c)(2)(A)) and (b) with, or before providing, a consumer report for employment purposes (15 U.S.C. § 1681b(b)(1)(B)). Similarly, a user must provide the Summary (a) with the required disclosure before procuring an investigative consumer report (15 U.S.C. § 1681d(a)(1)) and (b) with pre-adverse action notices for employment purposes (15 U.S.C. § 1681b(b)(3)).

The CFPB corrected the contact information in the Summary model form for multiple federal agencies (including the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC)), updating references to obsolete business types, and making other technical corrections.

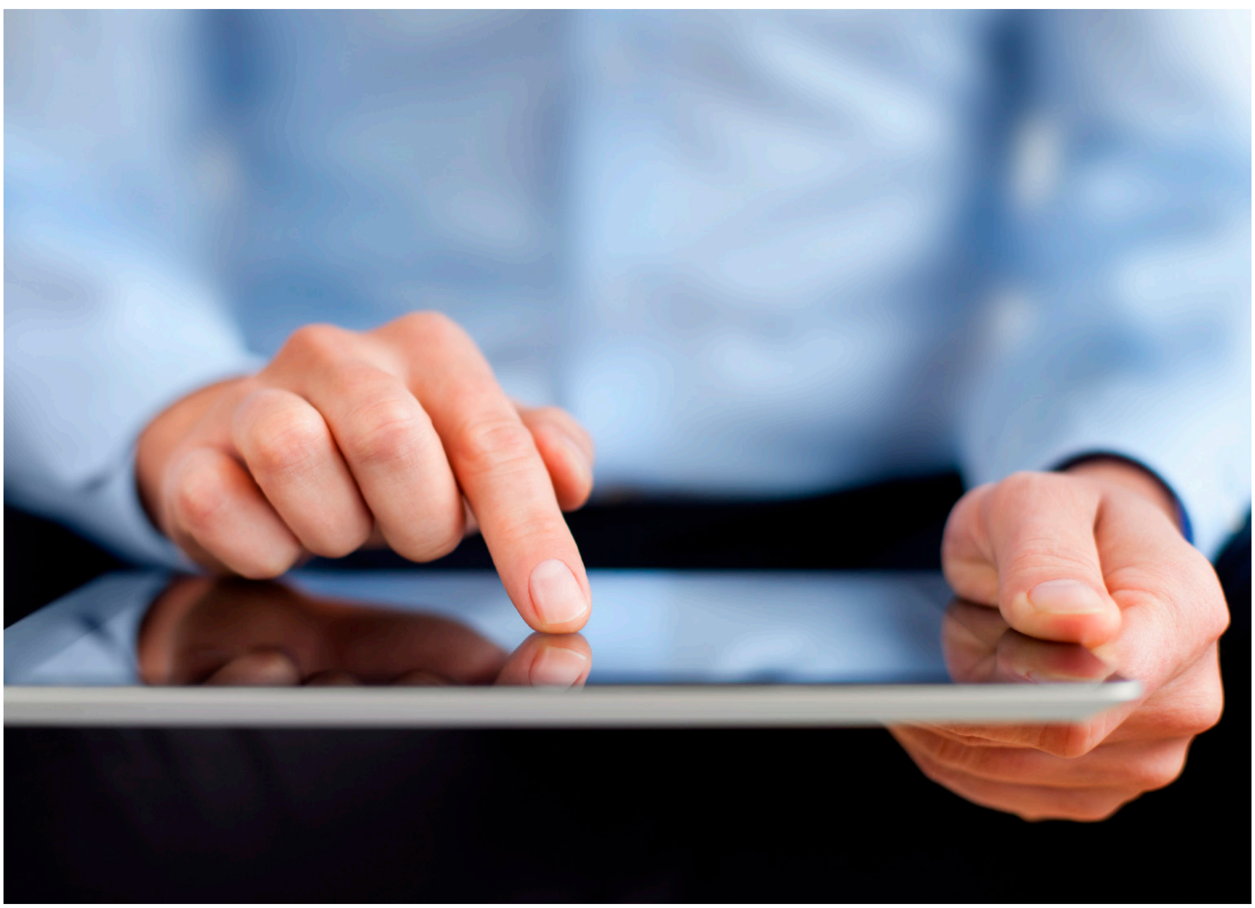
The ECOA (codified as Regulation B), 12 C.F.R. § 1002.9(b)(1) provides model language that satisfies certain disclosure requirements of § 1002.9(a)(2) relating to adverse action notices. These notices must include federal agency contact information located in Appendix A to Regulation B. The CFPB revised Appendix A to update agency contact information, including the OCC, FDIC, and FTC. It also amended paragraph 2 in Appendix D with a couple of minor corrections and updates.

The rule became effective April 19, 2023, but the mandatory compliance date for the amendments to the FCRA Summary of Consumer Rights is March 20, 2024.

The Background Screening Industry Defeats FCRA Claims

Courts saw no shortage of background screening litigation in 2023. In one important example, a federal court in California agreed with the employer's arguments to dismiss a claim that the employer's background check authorization forms violated the FCRA.

In *Keefer v. Ryder Integrated Logistics, Inc. et al.*, No. 21-cv-07503-HSG, 2023 U.S. Dist. LEXIS 17161 (N.D. Cal. Feb. 1, 2023), the plaintiff applied to work for Ryder Integrated Logistics, Inc. (Ryder Integrated), which provided the plaintiff with a disclosure and authorization form to perform a background investigation. The disclosure stated: "By signing below, you hereby authorize the Company to procure report(s) on your background as described above from any third-party or consumer reporting agency contacted by the Company."



Although the plaintiff signed the disclosure, he sued Ryder Integrated for violating the FCRA's disclosure requirements. Specifically, he alleged that the disclosures were (1) not clear and conspicuous and (2) not contained in a standalone document. The plaintiff first challenged that the disclosure was not clear and conspicuous because there were two different disclosures and the phrase "third-party or consumer reporting agency" created confusion as to the person or entity that would be used to prepare the report. He also argued that the disclosure violated the standalone document requirement by including extraneous information such as hyperlinks, the defendant's logo, and navigation buttons.

First, the court found the disclosure was "clear and conspicuous." The court held that the phrases "third-party agency or consumer reporting agency" and "the Company" did not create confusion as to which company would be obtaining the consumer report. Because the plaintiff applied for a position with Ryder Integrated and provided his consent for that employer to procure a consumer report, these phrases did not prevent the disclosure from being "reasonably understandable."

Second, the court found the disclosure complied with the standalone document requirement, which requires the disclosure be in a standalone document without any extraneous information. The court rejected the argument that the employer's logo, navigation buttons, list of reasons for requesting a consumer report, and "Application FAQs" hyperlink were extraneous information that should not have been presented with the disclosure and authorization form. Particularly, the court found that the contested language merely provided the applicant with useful information.

The decision handed down by the Arkansas Supreme Court is a win for background screeners and their customers who rely on public records, such as court records, to make important decisions about consumers in a variety of different areas.

The decision can be used as a helpful tool for defendants to counter allegations that their background disclosures violate 15 U.S.C. § 1681b(b)(2)(A).

Conclusion

The CFPB's and FTC's updated disclosures, as well as their regulatory and enforcement actions in 2023, revealed their keen interest in the accuracy of tenant background checks and the impact of errors on potential tenants. That regulatory scrutiny will undoubtedly continue in 2024 and will likely be seen not only in tenant screening but also in employment screening and other related areas. We expect this will result in an uptick in activity in the judicial branch as background screening companies continue to adapt to the shifting regulatory environment. ■

BANKRUPTCY

Contributors: Joseph DeFazio, Jared Bissell, Peter Yould

Bankruptcy filings increased by double digits in the past year — a trend we expect to continue in 2024 — but business bankruptcies haven't reached the level seen during the 2020 pandemic. A number of court cases clarified issues ranging from fee structures to the application of sovereign immunity and the discharge of debt incurred by fraud. Here's our brief review of key bankruptcy developments in 2023 and what we expect to see in the year to come.

Bankruptcy Filing Trends

- Bankruptcy filings increased 13% from 2022 to 2023. Business filings saw the largest increase at 30%, while individual filings rose 12.4%. Business filings surpassed the 2021 and 2022 figures, although they have not yet reached 2020 figures.
- Although filings increased in 2023, the total bankruptcy filings for both businesses and individuals combined remains lower than they were pre-pandemic.
- There was a significant increase of borrowers filing bankruptcies seeking to discharge student debt and receiving full or partial discharge due to the institution of updated bankruptcy guidelines in the fall of 2022.

Key Cases

Clinton Nurseries of Md., Inc. v. Harrington (In re Clinton Nurseries, Inc.), 53 F.4th 15 (2d Cir. 2022)

- The U.S. Court of Appeals for the Second Circuit ruled that the 2018 difference in fees between bankruptcy cases filed in bankruptcy administrator judicial districts and U.S. trustee judicial districts violated the Constitution's requirement for "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I, § 8, cl. 4
- The Supreme Court vacated the Second Circuit's judgment and remanded the case back to the Second Circuit for further consideration of the Supreme Court's decision in *Siegel v. Fitzgerald*, 596 U.S. 464 (2022).
- The Second Circuit issued an amended opinion reinstating its judgment, noting that the Supreme Court's ruling aligns with the Second Circuit's prior ruling, and directed the Bankruptcy Court to refund the amount of fees paid in excess of what would have been paid in a Bankruptcy Administrator district.
- The trend for the remedy set forth in Clinton Nurseries has been continued in *Pitta v. Vara (In re VG Liquidation, Inc.)*, Nos. 18-11120 (JTD), 22-50416 (JTD), 2023 Bankr. LEXIS 1320 (Bankr. D. Del. May 18, 2023), where the U.S. Bankruptcy Court for the District of Delaware ordered a refund of the amount of fees paid in excess of what would have been paid in a bankruptcy administrator district.

Lac du Flambeau Band of Lake Superior Chippewa Indians et al. v. Brian Coughlin, 599 U.S. 382 (2023)

- The Supreme Court held that U.S. bankruptcy law applies to all creditors, including Native American Tribes.

Although filings increased in 2023, the total bankruptcy filings for both businesses and individuals combined remains lower than they were pre-pandemic.

- Petitioner, a Native American Tribe, argued that sovereign immunity of the Tribes entitled it to continue to collect debt of the bankrupt despite the automatic stay typically afforded to debtors in bankruptcy.
- A Tribe-owned lender, Lendgreen, had lent money to Coughlin, a Tribe member, with a high-interest payday loan, but Coughlin filed Chapter 13 bankruptcy before he repaid the debt. Lendgreen, under a theory of Tribal sovereign immunity, continued to attempt to collect on the debt after Coughlin filed bankruptcy while the automatic stay was in place.
- The Supreme Court held that the U.S. Bankruptcy code "abrogates the sovereign immunity of any and every government" including the Tribes.
- Although the ruling may have greater implications on the doctrine of sovereign immunity than it will on bankruptcy law, this broad ruling clarifies the reach of the U.S. Bankruptcy Code's debtor protections against governments of all types.

***Bartenwerfer v. Buckley*, 598 U.S. 69 (2023)**

- The Supreme Court held Section 523(a)(2)(A) exception to discharge applies to debt incurred by fraud of another.
- The debtor in bankruptcy sought discharge of a judgment debt arising from a state court judgment against the bankruptcy debtor and her husband for fraudulently failing to disclose the condition of a house they sold.
- Despite the bankruptcy court finding the husband, not the wife, carried out the fraud, the Supreme Court held 523(a)(2)(A) applied, and the wife could not discharge that debt in bankruptcy.
- The Court reasoned that the judgment debtor's wife's debt was "obtained by actual fraud" regarding of who committed the fraud.
- This ruling could have beneficial implications for creditors seeking to collect on consumer debt where fraud or identity theft was present in the application process.

Looking Forward to 2024

We expect that consumer bankruptcy filings will continue to increase in 2024 as interest rates continue to be higher than in recent history, borrowers' savings accrued during the pandemic are reduced, knowledge regarding loosened requirements related to student loan debt discharge becomes more readily available, and the restarting of student loan payments continues to impact borrowers.

We expect that the increase of corporate debt defaults will also play into an increase of business bankruptcy filings in 2024 with a peak by the end of the first quarter of 2024, as estimated by Charles Schwab. ■

CONSUMER CLASS ACTIONS

Contributors: Timothy St. George, Megan Burns, Peter Cox, Kathleen Knudsen

Federal courts continued to develop consumer class action law in 2023, weighing in on conflicts of interest and privilege issues, class ascertainability, when to tackle the issue of Article III standing for putative class members, the "juridical link" doctrine, and assessing the propriety of class settlements.

Ethics/Attorney-Client Privilege

A pair of decisions from the Second Circuit raised concerns about conflict of interest between class representatives and absent class members based on class representative service awards. In *Fikes Wholesale, Inc. v. HSBC Bank USA, N.A.*, 62 F.4th 704, 721 (2d Cir. 2023), the court stated that "service awards are likely impermissible under Supreme Court precedent." However, "providing incentive payments to class representatives for their role in advancing litigation is, on its own, insufficient to create a conflict of interest." *Moses v. New York Times Co.*, 79 F.4th 235, 256 (2d Cir. 2023).

The Tenth Circuit reiterated its earlier decision that courts can "award fees on a percentage-of-the-fund basis, as opposed to the lodestar method." *In re Syngenta AG MIR 162 Corn Litig.*, 61 F.4th 1126, 1192 (10th Cir. 2023).

A district court in West Virginia ruled that attorney-client privilege attached "over communications between putative class members and class counsel prior to class certification." *Glover v. EQT Corp.*, No. 5:19CV223, 2023 WL 5321810, at *6 (N.D.W. Va. Aug. 14, 2023).

Ascertainability

One of the most important ascertainability cases in 2023 came from the Third Circuit, which applied a heightened standard similar to the standard already in play in the First and Fourth Circuits. "The ascertainability standard, including the administrative feasibility principle it contains, is true to the text, structure, and purpose of Rule 23… What we call 'ascertainability' and 'administrative feasibility' is merely the way courts perform that role, a practice familiar under the civil rules." *In re Niaspan Antitrust Litig.*, 67 F.4th 118, 132 (3d Cir. 2023).

When To Determine Standing

The circuit split continues as to when, procedurally, a court should decide the issue of standing relative to unnamed class members — at the beginning of the case or as part of the class certification analysis. Some courts assess only the named plaintiff's individual standing. If the named plaintiff has standing, any remaining analysis is considered a matter of class certification under Rule 23. *See, e.g., Fallick v. Nationwide Mut. Ins. Co.*, 162 F.3d 410, 423 (6th Cir. 1998). In contrast, other courts compare the injuries or interests of the named plaintiff with those of the putative class and will hold that the named plaintiff lacks standing for the class claims if his or her harms are not sufficiently analogous to those suffered by the rest of the class. See*, e.g., In re Asacol Antitrust Litig.*, 907 F.3d 42, 49 (1st Cir. 2018).

In two Fifth Circuit cases decided this year, the court — while describing the circuit split in some detail — declined to adopt a specific approach because it found that the representative plaintiffs there satisfied both approaches. *Angell v. Geico Advantage Ins. Co.*, 67 F.4th 727 (5th Cir. 2023); *Chavez v. Plan Benefit Services, Inc.*, 77 F.4th 370 (5th Cir. 2023).

In *Green-Cooper v. Brinker Int'l*, 73 F.4th 883 (11th Cir. 2023), the Eleventh Circuit confirmed its position that differences between the injuries of the class representative and absent class members should be addressed at certification. The case involved a data breach at Chili's restaurants that resulted in the theft of the class members' credit card information. The court held that only the named plaintiffs needed to show Article III standing, and that the plaintiffs had sufficiently alleged a concrete injury by asserting that the hackers "took these individuals" data and posted it" publicly. *Id.* at 889.

The Sixth Circuit Rejects the "Juridical Link" Doctrine

Weighing in on yet another circuit split, the Sixth Circuit in *Fox v. Saginaw Cnty*, 67 F.4th 283 (6th Cir. 2023) addressed the "juridical link" doctrine, which some courts have used to jettison the standing element that the plaintiff's injury be fairly traceable to the defendants' conduct in the class action setting. That doctrine, previously adopted by the Seventh Circuit (*Payton v. Cnty. of Kane*, 308 F.3d 673, 678 (7th Cir. 2002)), allows a named plaintiff in a putative class action to sue defendants who have not injured the plaintiff if these defendants have injured absent class members. In rejecting the juridical link doctrine, the Sixth Circuit held that the doctrine departs from Supreme Court precedent that class representatives must prove their own cases or controversies with each defendant in order to seek relief for any other member of the class; they cannot piggyback off the injuries suffered by others.

Class Settlements and Related Judicial Scrutiny

In 2023, several U.S. federal appellate courts took hard looks at class settlements, reversing and remanding district court approvals of settlement agreements the appellate courts found problematic. Notable decisions include:

- In *Lowery v. Rhapsody Int'l, Inc.*, 75 F.4th 985 (9th Cir. 2023), the Ninth Circuit found that an attorney fee award was "not reasonable under Rule 23" when it was *30 times* larger than the actual amount paid out to class members. *Id*. at 991. The court held "that courts must consider the actual or realistically anticipated benefit to the class — not the maximum or hypothetical amount — in assessing the value of a class action settlement." Id. at 992.

- In *Williams v. Reckitt Benckiser LLC*, 65 F.4th 1243 (11th Cir. 2023), the Eleventh Circuit reiterated the requirement that named plaintiffs must have standing to seek all relief afforded in the class settlement. In *Williams*, the Eleventh Circuit vacated and remanded a class settlement that included injunctive relief because the named plaintiffs had not adequately pled that they had standing to seek such relief. *Id*. at 1256-57. The court directed that "on remand, the [district] court should account only for relief that the Named Plaintiffs have standing to pursue and that it has jurisdiction to grant when assessing the overall fairness of any settlement (assuming, of course, that the parties reach a new settlement agreement and submit it for the district court's approval)." *Id*. at 1258.

These decisions are a reminder that district courts will seriously evaluate whether the settlement is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2). ■

CONSUMER CREDIT REPORTING

Contributors: Kim Phan, Alan Wingfield, Eli Kaplan, Carter Nichols, Sarah Reise, Zachary Turk

Below is an overview of the major events and legal decisions surrounding consumer reporting in 2023. The law governing the consumer reporting ecosystem — data brokers and aggregators, furnishers, consumer reporting agencies (CRAs), and users — continues to evolve through both planned rulemaking and case law.

CFPB Rulemaking

On September 21, 2023, the Consumer Financial Protection Bureau (CFPB) released an outline of its rulemaking plans under the Fair Credit Reporting Act (FCRA). The CFPB sets out an expansive agenda that will have major impacts across all aspects of the consumer reporting ecosystem.

First, entities known as data brokers and data aggregators would potentially become regulated as consumer reporting agencies (CRAs). These entities are not defined under the FCRA and have not historically been considered CRAs. For example, the CFPB states that it intends to apply the FCRA where information is used for any permissible purpose, regardless of whether a data broker knew that the information would be used, or was intended to be used, for that purpose.

Second, CRAs will face new limitations and duties under the proposed regulations. The CFPB seeks to reclassify "credit header data" as regulated consumer report information that can only be used for FCRA permissible purposes. The proposed regulations may also create a new duty "to protect" consumer reports from a data breach or data security incident, which the CFPB characterizes as a disclosure without a permissible purpose.

Third, the CFPB proposes to exclude any reporting on or use of medical debt collection information in consumer reports.

Fourth, the CFPB intends to amend the dispute process to require CRAs and furnishers to conduct investigations into legal disputes and systemic disputes.

Fifth, the CFPB is contemplating imposing specific requirements for obtaining a consumer's written instructions to access a consumer report as well as limit the ability of end users to rely on the FCRA "legitimate business need" permissible purpose to access a consumer report.

Draft rules are expected in 2024, although a final rule is unlikely before 2025. Based on the sweeping changes proposed, including some that contradict the plain language of the FCRA, the CFPB's proposed rule will likely face significant legal challenges.

Furnishers

Circuit courts and the CFPB placed continued scrutiny on the activities of furnishers.

In *Aargon Agency, Inc. v. Sandy O'Laughlin*, the Ninth Circuit upheld a Nevada law that imposes a 60-day waiting period on debt collectors before they can take "any action to collect such debt." In doing so, the Ninth Circuit rejected challenges to the law premised on First Amendment and FCRA preemption arguments.

In *Frazier v. Dovenmuehle Mortgage, Inc.*, the Seventh Circuit held that the completeness or accuracy of an e-OSCAR Automated Credit Dispute Verification (ACDV) response is determined by the information provided in that response. To the extent that a CRA may incorrectly interpret information provided in that response, that interpretation would not impose liability on the furnisher.

In contrast to this layer of insulation established between furnishers and CRAs in *Frazier*, the Third Circuit expanded a furnisher's responsibility in *Ingram v. Experian Information Solutions, Inc.*, holding that furnishers have a duty to conduct some measure of investigation into all indirect disputes and cannot meet their obligation to investigate by asserting that a dispute is frivolous.

On the regulatory side, the CFPB entered into a consent order with Phoenix Financial Services due to the alleged failures in its processes for verifying disputes of medical debt and in investigating the accuracy of its reporting. In particular, the CFPB alleged that Phoenix neither had nor obtained documentation to support the purported debts it was attempting to collect. The CFPB further asserted that Phoenix employed so few investigators that each would spend less than thirty (30) seconds on average investigating a dispute.

Consumer Reporting Agencies

The debate over whether CRAs may be held liable under the FCRA for alleged reporting inaccuracies based on legal questions continues to be unresolved among circuit courts.

This year, the Second Circuit held in two decisions that CRAs are not liable for inaccuracies that turn on unsettled legal questions but stopped short of holding that there is a bright-line rule that no legal questions are actionable under the FCRA. Instead, the court focused the inquiry on whether the alleged inaccuracy involves "objectively and readily verifiable information." *See Mader v. Experian Info. Sols., Inc.*, 56 F.4th 264, 269-71 (2d Cir. 2023); *Sessa v. Trans Union, LLC*, 74 F.4th 38, 42-43 (2d Cir. 2023).

This issue also continues to percolate in federal district courts, and we expect to see more litigation on this question in the coming year. *See, e.g.*, *Cunningham v. Trans Union, LLC*, No. 2:22-cv-3331, 2023 WL 6823182 (S.D. Ohio Oct. 11, 2023); *Riser v. Cent. Portfolio Control Inc.*, No. 3:21-cv-05238, 2023 WL 2742075 (W.D. Wash. Mar. 31, 2023).

The CFPB and the Federal Trade Commission (FTC) continued to focus on tenant screening reports. In a recent enforcement action involving a nationwide credit bureau, the agencies emphasized the need for transparency related to the sources of reported information and overall accuracy in such reports.

End Users

Courts continued to grapple with issues of standing for claims involving end users' use of background check reports.

In the Northern District of Ohio, the court in *Gray v. Nachurs Alpine Sols., LLC*, No. 3:21-CV-125, 2023 WL 3004433 (N.D. Ohio Apr. 19, 2023), opined that standing could exist when a procedural violation occurs and there is inaccurate information on the plaintiff's report that causes the plaintiff to suffer an adverse employment action. The plaintiff in *Gray*, however, was unable to demonstrate standing because the information in the background check report was accurate and disqualified the plaintiff from the employment opportunity.

In contrast, the Eastern District of Michigan found in *Messina v. S&A Sols., Inc.*, No. 22-CV-10706, 2023 WL 6397749 (E.D. Mich. Sept. 30, 2023) that standing could exist when a procedural violation occurs even if the information contained in the report was accurate. In *Messina*, the plaintiff established standing because the information in the background check report, while accurate, did not automatically disqualify the individual from the employment opportunity, but the individual was not provided a copy of the report or an opportunity to address the information before being denied the job in question.

In another development, the Northern District of Indiana in *Reed v. United States Postal Serv.*, No. 2:21-CV-152-JEM, 2023 WL 3568111 (N.D. Ind. May 18, 2023) ruled that supplying a copy of a criminal background report without additional information satisfies the FCRA's pre-adverse action requirement. ■

DEBT COLLECTION

Contributors: Stefanie Jackman, Jim Trefil, Jonathan Floyd, Joshua Howell, Stephen Lozier

Total consumer debt balances continued to grow in 2023 and Americans owed a record high $1.1 trillion in credit card debt as of the third quarter of 2023. Despite the increase in household debt, federal lawsuits brought under the Fair Debt Collection Practices Act (FDCPA) slowed, with filings through the third quarter of 2023 down by approximately 13.4% compared with the same period in 2022, while state lawsuits increased as courts continued to find that consumers seeking to merely recover statutory damages often lack Article III standing. *See* WebRecon Oct 2023 Stats: TCPA & FCRA Down, FDCPA Up - WebRecon LLC. Below we outline the major themes from the debt collection industry space in 2023.

Evolving FDCPA Theories of Liability

Lawsuits asserting an evolving theory of liability against debt collectors based on the furnishing of credit information continued to gain momentum in 2023. These hybrid consumer claims typically assert violations of the FDCPA for multiple or ongoing trade line disputes and sidestep the Fair Credit Reporting Act's (FCRA) threshold requirement that the consumer submit their dispute to a consumer reporting agency before filing a lawsuit. In general, these lawsuits essentially challenge the ability of the available Metro 2 Compliance Condition Codes to adequately convey a consumer dispute under the FDCPA, which states that "the failure to communicate that a disputed debt is disputed" may be a "false, deceptive, or misleading representation" in connection with the collection of a debt. 15 U.S.C. § 1692e(8).

Although it was a less prominent issue, courts also struggled with the application of Regulation F to the FDCPA in 2023. For example, in *Roger v. GC Services, LP*, a consumer filed a lawsuit alleging a debt collector violated the FDCPA by sending an undated validation notice (the model notice offered by the CFPB also did not have a place for a date). No. 22-23192, 2023 U.S. Dist. LEXIS 22279, at *1 (S.D. Fla. Feb. 9, 2023). The plaintiff contended that the missing date amounted to a withholding of a "material term" about the amount of the debt because the letter also included the words "today" and "now" when describing the total amount due and the amount of interest incurred to date. *Id*. at *2-3.

Despite the safe harbor provided by Regulation F's Model Validation Notice, the court denied the defendant's motion to dismiss, holding that using the model notice did not ensure compliance with the FDCPA because the model notice arose only from the CFPB's implementing regulations, not from the FDCPA itself. In other words, there could be a safe harbor for a claim under Regulation F, but that did not mean there was a safe harbor if a letter violated the FDCPA. Id. at *10-11. The court also concluded that dismissal was inappropriate because, even if the safe harbor rules applied to the FDCPA's statutory requirements, the CFPB's safe harbor applied only to the form of the letter, not the content, which in this case may have been misleading. Id. at *11, 17-18. Other courts have held similarly. *See, e.g., Ginsberg v. I.C. System, Inc.*, No. 22-1147, 2023 U.S. Dist. LEXIS 148470 (D.N.J. Aug. 23, 2023).

The use of the model validation notice will remain an issue in FDCPA cases as courts continue to struggle with Regulation F's safe harbor provisions under similar facts. *See Bergida v. Plusfour Inc.*, No. 2:22-cv-02150, 2023 U.S. Dist. LEXIS 194617, at *6, *9-10 (D. Nev. Oct. 31, 2023). (Refusing to apply the Regulation F safe harbor but, nevertheless, ruling that nothing in § 1692g(a) requires a date on the notice and the plaintiff did not plausibly allege how omitting the date impacted information about the amount due.) *Loeffler v. Fleming*, No. 23 CV 1098, 2023 U.S. Dist. LEXIS 207439, at *6, *13-14 (S.D.N.Y. Nov. 20, 2023) (same).

The U.S. Supreme Court Considers the CFPB's Constitutionality

On October 3, the U.S. Supreme Court heard arguments in *Consumer Financial Protection Bureau v. Community Financial Services Association of America*, No. 22-448, a case challenging the funding of the CFPB as unconstitutional under the Appropriations Clause. Previously, the Fifth Circuit

Court of Appeals ruled that the funding mechanism was unconstitutional, and if the Supreme Court affirms the Fifth Circuit's decision, the future of the Bureau as well as its rulemaking and enforcement actions would be in question. The court's decision is expected in June 2024.

This term, the court also will decide two separate appeals challenging its *Chevron* deference precedent: *Relentless Inc., et al. v. Dept. of Commerce, et al.*, No. 22-1219, and *Loper Bright Enterprises, et al. v. Gina Raimondo*, No. 22-451. Both involve companies challenging federal regulations requiring them to pay for at-sea government monitoring of their herring catches. To the extent the court announces any departure from its long-standing deference to federal agencies under *Chevron* in these cases, expect it to have impact in the collection space — particularly with respect to what extent, if any, courts must defer to Regulation F.

Medical Debt Remains Under Extreme Scrutiny

The CFPB's crackdown on medical debt collection continued in 2023, culminating in September when the White House announced a plan to eliminate medical debt from credit reports. The move — which follows an earlier decision from the three main credit bureaus to eliminate the reporting of paid medical debt, medical debt that's less than a year old, and medical debt balances lower than $500 — could affect the tens of millions in the U.S. who have unpaid medical bills and destroy the medical debt collection industry. Debt collectors working on behalf of medical service providers should review their collection procedures as well as the billing, collection, and credit reporting policies of their clients to protect themselves proactively from the aggressive regulatory oversight, enforcement, and civil litigation that already has begun.

According to the CFPB, debt collectors also risk violating the FDCPA when using a third-party payment processor that charges convenience fees if the processor remits any amount of the fee to the collector.

The CFPB and FTC Target Convenience Fees

The CFPB previously issued an advisory opinion in 2022 declaring that the FDCPA prohibits debt collectors from collecting "pay-to-pay" or convenience fees unless applicable law or the agreement creating the debt expressly authorized that fee. According to the CFPB, debt collectors also risk violating the FDCPA when using a third-party payment processor that charges such fees if the processor remits any amount of the fee to the collector.

In 2023, the FTC joined the convenience fee fight by proposing a broad ban on hidden fees throughout the economy. The rule would require companies to incorporate and disclose all mandatory fees in the display price of a good or service so consumers aren't hit with surprise costs after they agree to make a purchase.

Following the FTC's announcement, the CFPB issued an advisory opinion interpreting § 1034(c) of the 2010 Consumer Financial Protection Act, which generally prohibits large banks and credit unions from imposing unreasonable obstacles on customers, such as charging excessive fees, for basic information about their own accounts. Under § 1034(c) of the CFPA, codified at 12 U.S.C. § 5534(c), large banks and credit unions must provide complete and accurate account information in a timely manner when requested by account holders, and the CFPB's advisory opinion clarifies that people are entitled to obtain the basic information they need without having to pay unnecessary fees.

The debt collection industry experienced wide-ranging, industry-altering changes in the regulatory and legal landscape in 2023 that are sure to impact the industry's participants into 2024 and beyond. Industry participants should stay apprised of these and other developments and take all appropriate action to ensure compliance with the various consumer protection laws and regulations in the coming year. ■

DIGITAL ASSETS

Contributors: Kalama Lui-Kwan, Ethan Ostroff, Addison Morgan, Trey Smith, Amanda Sterling, Joseph Toll

The digital asset industry moved past an inflection point and entered a zone of maturation during 2023. Despite being nascent, the uptick in digital asset-related consumer litigation, federal and state legislative initiatives, and high-profile enforcement actions has verified the industry's staying power, which we believe will only become more permanent during 2024.

This overview examines the latest digital asset-related trends through the lens of their potential impact on traditional financial services companies.

Consumer Litigation Developments

In 2023, we saw a noticeable shift in reliance on the Electronic Funds Transfer Act (EFTA) and its implementing regulation, Regulation E, to obtain recourse for consumers who allege they have been harmed by unauthorized digital asset transactions.

The Southern District of New York is the only district court that has opined on the EFTA's application to digital asset transactions, and the judges on this court are split on whether the EFTA is applicable.

In Rider v. Uphold HQ Inc., the court determined that Uphold HQ, Inc. (Uphold) — a digital asset exchange — was a "financial institution" under the EFTA and held that digital assets, as "liquid, monetary assets" are "funds" under the EFTA, although the statute does not expressly define the term "funds." The Rider court denied Uphold's motion to dismiss the plaintiff's EFTA claim.

However, in Yuille v. Uphold HQ Inc., the court did not address whether the term "funds" encompasses digital assets. Instead, the court dismissed the plaintiff's EFTA claim on the basis that the exchange account plaintiff established with Uphold did not constitute an "account" created primarily for personal, family, or household services. The court held that an account established for "profit-making purposes" akin to investing does not constitute an account within the spirit and letter of the EFTA.

As Regulation E contains onerous disclosure and error-resolution requirements meant to protect consumers in electronic funds transfers, this current interpretive split is a very important compliance issue that industry stakeholders should closely monitor.

Federal Developments

Federal Legislation Developments

2023 marked a significant year for digital asset regulation in the United States, with the introduction of several key pieces of legislation in Congress.

These include the McHenry-Thompson Financial Innovation and Technology for the 21st Century Act, the Lummis-Gillibrand Responsible Financial Innovation Act, the Digital Asset Market Structure and Investor Protection Act, and the Digital Asset Anti-Money Laundering Act.

- The McHenry-Thompson and Lummis-Gillibrand bills focused on integrating digital asset regulation into the existing U.S. regulatory framework, with a particular emphasis on dividing regulatory oversight between the CFTC and the Securities and Exchange Commission (SEC).
- The Digital Asset Market Structure and Investor Protection Act took a similar approach, providing for the classification and registration of digital assets as well as their treatment under the Commodity Exchange Act and the Bank Secrecy Act (BSA).
- In contrast, the Digital Asset Anti-Money Laundering Act focused nearly exclusively on extending BSA responsibilities to various digital asset network participants addressing the issue of "unhosted" digital wallets; and strengthening enforcement of BSA compliance. It also directed the Financial Crimes Enforcement Network (FinCEN) to issue guidance on mitigating the risks associated with anonymized digital assets and requires U.S. persons to report certain offshore digital asset transactions.

Despite their unique focuses, the bills highlighted the complexity of digital asset regulation and the divergent viewpoints of each bills' proponents.

Federal Enforcement-Related Developments

Throughout 2023, federal regulators continued to embody a theme that became ubiquitous during 2022: innovation is not an exemption to existing financial services laws. Historically, the BSA's anti-money laundering (AML) requirements have been the touchstone of regulatory authority over entities within the digital asset industry. However, it has also become apparent that marketing representations that a digital asset company presents to consumers will be a focal point of scrutiny for regulators throughout 2024.

- United States of America v. Binance Holdings Limited, d/b/a Binance.com: In November, the Department of Justice (DOJ), alongside parallel enforcement actions filed by the Commodity Futures Trading Commission, FinCEN, and the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC), entered a consent order with foreign digital asset exchange Binance.com — the world's largest digital asset exchange — for allegedly failing to register as a "money services business" with FinCEN, maintaining an ineffective AML program, and providing digital asset services to consumers residing in jurisdictions that have been sanctioned by OFAC. In the aggregate, Binance.com was required to pay $4.3 billion in penalties to the U.S. government to resolve these allegations.
- In November, the Federal Trade Commission (FTC) entered a consent order with a bankrupt digital asset services company for portraying to its customer base that digital assets deposited into its platform were protected by deposit insurance offered by the Federal Deposit Insurance Corporation (FDIC). Under the FTC's allegations, it does not appear that the company expressly stated that a consumer's *digital asset deposits* (whether a stablecoin or a non-stablecoin digital asset) were protected by FDIC insurance, but instead stated that "USD held with [the company] is FDIC insured up to $250K." However, this, and similar statements made by the digital asset services company were deemed misleading by the FTC, which has permanently barred the entity from handling consumer digital assets in the future.

State-Level Developments

With Congress still some distance from enacting comprehensive digital asset legislation, states have continued working toward their own regulatory measures, including the following:

- **California:** In October 2023, California Governor Gavin Newsom signed the California Digital Financial Assets Law (DFAL). This new law, which will take effect on July 1, 2025, establishes a regulatory framework for digital asset activities in California, including license requirements, compliance obligations, and specific guidelines for stablecoins. On November 20, 2023, the California Department of Financial Protection and Innovation issued an invitation for comments on proposed application-related rulemaking under the DFAL.
- **New York:** On April 17, the New York Department of Financial Services (NYDFS) announced it had adopted a final regulation establishing how companies with NYDFS-issued BitLicenses will be assessed for costs of their supervision examination. In May 2023, New York Attorney General Letitia James introduced the Crypto Regulation, Protection, Transparency, and Oversight Act (CRPTO Act). The Act categorizes digital asset industry participants into five types and imposes specific requirements on each to enhance transparency, eliminate conflicts of interest, and strengthen investor protections.

Looking Ahead

Although the digital asset industry is poised to undergo significant transformations in 2024, one of the most noteworthy changes anticipated is the requirement for digital asset services companies to issue clear and conspicuous disclosures to their customers. We also expect Congress and regulators to focus on Regulation E's disclosure and error resolution requirements to support a consumer protection framework for digital assets. The CFPB is currently evaluating how the EFTA may apply to digital asset platforms. Collectively, these expected changes aim to enhance transparency in digital asset transactions and underscore the unceasing importance of consumer protection and informed consent in an increasingly digital financial world. ■

FAIR LENDING AND UDAAP

Contributors: Lori Sommerfield, Chris Willis, Christine Emello, Sarah Pruett

During 2023, the federal regulatory agencies continued to aggressively enforce the federal fair lending laws (the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act). The "whole of government" approach to ensuring compliance with federal fair lending laws, adopted by the Biden administration, continued with unprecedented levels of interagency action. In addition, the CFPB continued its efforts to expand use of its UDAAP authority, which is already broad, but met with limited success. Highlights from the past year are set forth below.

Fair Lending

- **Redlining:** Since 2021, the DOJ has announced 10 redlining settlements with banks and mortgage lenders and secured more than $107 million in consumer relief, including the largest ever redlining settlement ($31 million). Six of these settlements occurred in 2023 alone, and the DOJ has stated that it intends to focus on reverse redlining and steering practices next. In addition, the DOJ and CFPB have jointly prioritized digital redlining, including algorithmic bias, to root out "modern day redlining." With more than 24 active redlining investigations currently pending at the DOJ alone, the Combatting Redlining Initiative continues unabated and remains unparalleled in terms of a federal government crackdown on alleged redlining practices.
- **Appraisal Bias:** In 2023, the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) continued to address appraisal bias in residential mortgage lending. In February, the Consumer Financial Protection Bureau's (CFPB), Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), Housing and Urban Development (HUD), the Federal Housing Finance Agency (FHFA), and the Department of Justice (DOJ) issued a joint letter to The Appraisal Foundation urging it to revise the Uniform Standards of Professional Appraisal Practice to include a detailed statement of federal prohibitions against discrimination. In March, the DOJ and CFPB jointly filed a statement of interest in a pending lawsuit to explain the application of the Fair Housing Act and ECOA to lenders relying on discriminatory home appraisals. In June, the CFPB, FRB, OCC, FDIC, NCUA, and FHFA published a proposed automated valuation model (AVM) rule, referencing both home appraisal bias in mortgage lending and algorithmic bias but providing no guidance on how to address those issues.

- **Artificial Intelligence (AI):** President Biden issued an executive order in October directing federal agencies to review existing rules and explore new rulemakings governing the use of AI in order to promote its safe and responsible use. The order directs, in part, the DOJ to discuss preventing and addressing discrimination in the use of automated systems, including algorithmic discrimination; coordinate with civil rights offices on issues related to AI and algorithmic discrimination; and promote public awareness of potential discriminatory uses and effects of AI. The order encourages HUD and the CFPB to issue guidance addressing the use of tenant screening systems in ways that may violate federal law, including how the use of certain data can lead to discriminatory outcomes, and to address how the FHA, CFPA, and ECOA apply to the advertising of housing, credit, and other real estate-related transactions through digital platforms, including those that use algorithms to facilitate advertising.

- **Targeted Advertising:** In January, the DOJ and Meta entered into a settlement to resolve allegations of discriminatory advertising practices involving algorithmic bias. The settlement required Meta to stop using the targeted advertising tool known as Special Ad Audience for credit advertisements because it allegedly used a machine-learning algorithm that considered protected characteristics in finding Facebook users who shared similarities with an advertiser's source audience.

- **HUD Disparate Impact Final Rule:** In March 2023, HUD issued a final rule reinstating the original 2013 version of its disparate impact rule under the Fair Housing Act. The final rule describes a three-step burden-shifting test for determining whether disparate impact exists when Fair Housing Act claims are brought, and the modified test will make it easier for HUD, the CFPB, and the federal banking agencies to bring disparate impact discrimination claims against lenders.

- **Section 1071 Final Rule:** In March, the CFPB issued a final rule implementing Section 1071 of the Dodd-Frank Act concerning small business loan data collection and reporting requirements. The final rule has two components: (1) technical data collection and reporting requirements and (2) fair lending elements, including the required collection of business status and the principal owners' demographic data. Although the final rule would have required some lenders to begin collecting data on October 1, 2024, a Texas federal district court ultimately granted a nationwide injunction covering all small-business lenders that enjoins the CFPB from implementing and enforcing the final rule until after the U.S. Supreme Court's decision in *CFSA v. CFPB*, an appeal from the Fifth Circuit's decision finding the CFPB's funding structure unconstitutional and thus rules promulgated by the Bureau invalid. If the Supreme Court overturns the Fifth Circuit decision, the nationwide injunction requires the CFPB to extend small-business lenders' compliance dates to compensate for the period stayed. We expect the Supreme Court to issue its decision in the *CFSA* case during the first half of 2024.

- **Community Reinvestment Act Final Rule:** In October, the FRB, FDIC, and OCC issued a final rule modernizing how the agencies assess lenders' compliance with the Community Reinvestment Act (CRA). The last comprehensive revisions to the CRA regulations occurred in 1995. Key goals of the final rule are encouraging banks to expand access to credit, investments, and banking services in low-to-moderate-income communities; adapt to changes in the banking industry (including mobile and online banking); provide greater clarity and consistency in the application of the CRA rules; and tailor CRA evaluations and data collection to bank size and type. Although the final rule becomes effective on April 1, 2024, it provides for a transition period. Provisions that are similar to the current CRA rule (facility-based assessment area delineations, the effect of CRA on applications, public file, bank public notice, and CRA examination schedule public notice provisions), as well the new public engagement provision, are effective April 1, 2024. By January 1, 2026, banks must comply with all other provisions of the final rule, except for certain reporting requirements that become effective on January 1, 2027.

- **Adverse Action Notice (AAN) Specificity:** ECOA and Regulation B require creditors to provide applicants with the "specific" "principal" reason(s) for any adverse action taken on a credit application or existing account, which must "relate to and accurately describe the factors actually considered or scored by a creditor." Appendix C to Regulation B contains sample notices with a list of common reasons for adverse action. However, in September, the CFPB issued guidance stating that, in many circumstances, lenders may not rely on the list of adverse action reasons provided in the sample forms unless the reasons disclosed are specific and indicate the principal reason(s) for the adverse action taken. For example, if a creditor lowers a consumer's credit line based on behavioral data (e.g., where the consumer shops), "purchasing history" or "disfavored business patronage" are insufficient descriptions in the AAN. Instead, the creditor would likely need to disclose details, such as the type of establishment, the location of the business, or the type of goods purchased. The CFPB's guidance applies equally to all credit decisions, regardless of whether the technology used to make them involves complex or "black box" algorithmic models or AI.

- **Immigration Status:** In October, the CFPB and DOJ issued a joint statement about the use of immigration status in credit decisioning. The agencies warned lenders that "unnecessary or overbroad" reliance on immigration status in the credit decisioning process may violate ECOA and other federal laws in part because immigration status may overlap with, or serve as a proxy for, protected characteristics such as race and national origin. The agencies recommended that creditors evaluate whether their reliance on immigration or citizenship status is necessary to ascertain their repayment rights and provided examples of potential ECOA violations.

UDAAP

- **CFPB Policy Statement on "Abusive" Conduct:** In April, the CFPB issued a revised policy statement attempting to again clarify its interpretation of "abusive" conduct under UDAAP. The policy statement replaces the prior version adopted under the leadership of former CFPB Director Kathleen Kraninger, which the CFPB rescinded in March 2021 shortly after President Biden took office. The new policy statement defines abusive practices more broadly to give the CFPB maximum flexibility in determining such practices in supervision and enforcement. Specifically, the Bureau further defines abusive practices as (1) obscuring important features of a product or service or (2) leveraging certain inequalities to take advantage of the consumer, including gaps in understanding, unequal bargaining power, and consumer reliance. According to the CFPB, conduct that underlies an abusiveness determination may also be found to be either "unfair" or "deceptive," depending upon the circumstances.

The new (UDAAP) policy statement defines abusive practices more broadly to give the CFPB maximum flexibility in determining such practices in supervision and enforcement.

- **CFPB's Revised UDAAP Examination Manual:** In September 2022, the U.S. Chamber of Commerce and several trade associations filed suit against the CFPB alleging that its UDAAP Examination Manual, issued in March 2022, went beyond the Bureau's authority to interpret UDAAP and should have been issued using public notice and comment procedures. The Bureau had issued the revised exam manual through a press release announcing that it would begin targeting discrimination as an unfair practice. This represented a massive sea change in the CFPB's interpretation of UDAAP and would apply to noncredit products and services for the first time. In September 2023, a federal district court in Texas granted summary judgment in favor of the plaintiffs, agreeing that the revised exam manual exceeded the Bureau's constitutional authority to interpret UDAAP.

- **War on "Junk Fees":** In October, the CFPB published a special edition of its Supervisory Highlights Report, underscoring the relief it has obtained for consumers since its March 2023 Special Fees Edition. The Bureau noted that its supervisory efforts have led to financial institutions refunding over $140 million in fees to consumers, including $120 million in overdraft and non-sufficient funds (NSF) fees. Simultaneously, the FTC announced a proposed rule to prohibit "hidden and bogus" fees. These initiatives, which received the explicit approval of President Biden, have created a coordinated federal attack on "junk fees." At the state level, California Governor Gavin Newsom signed into law Senate Bill 478 (SB 478), which would prohibit hidden fees for goods and services in California effective July 1, 2024. Specifically, California will prohibit advertising, displaying, or offering a price for a good or service that does not disclose all mandatory fees or charges other than taxes or fees imposed by the government. Companies that do not comply with the new law could face steep penalties.

What to Expect in 2024

We anticipate federal regulators will continue to vigorously pursue redlining investigations and enforcement actions as the signature issue of the Biden administration. In preparation for such examinations, lenders should routinely conduct fair lending and redlining analyses (including root cause analysis) to identify any need for corrective action.

Federal regulators also will continue to address appraisal bias and algorithmic discrimination in underwriting. In accordance with President Biden's Executive Order, we anticipate federal agencies will review existing rules and explore new rulemaking governing the use of AI. The CFPB has demonstrated hostility toward, and suspicion of, alternative data, machine learning, and AI, including by applying fair lending scrutiny to anti-fraud measures, and we expect the Bureau will continue to focus on potential discrimination in credit underwriting models that use AI or machine learning. As data use and credit models continue to evolve, lenders should take steps to mitigate these regulatory risks by ensuring their models comply with existing consumer protection laws and guidance, including Regulation B's adverse action requirements.

Although the CFPB experienced a setback in court concerning its proposed expansion of UDAAP authority through its revised examination manual, the Bureau will likely appeal that decision. Likewise, the decision in the *Townstone* case, in which the district court found that ECOA does not apply to persons until they become "applicants," is on appeal to the Seventh Circuit. We expect a decision on that appeal in 2024, which could have major implications for the authority of the Bureau and other regulators under ECOA. And we have no doubt the CFPB will continue to use its UDAAP authority broadly in supervision, investigations, and enforcement actions to attack behavior by financial institutions and financial services companies that it does not like, including its ongoing war on "junk fees." ■

FINTECH

Contributors: James Kim, Jeremy Rosenblum, Caleb Rosenberg, Jeremy Sairsingh

Buy Now, Pay Later

Buy Now, Pay Later (BNPL) has emerged as a popular form of consumer credit, and it is most commonly associated with no-interest, four-payment installment loans offered via integrations with merchant websites and virtual cards generated in shopping apps. The lender generally pays the merchant for the good or service and takes on the responsibility of collecting payments from the borrower, with the merchant paying a "merchant discount" for the lender's assumption of credit risk. The lender then collects the full purchase price through installment payments from the borrower, with 25% or more of the purchase price often paid up front. If the borrower does not pay on time, the lender may, at times, charge late fees and refuse to make additional BNPL loans to the borrower until the borrower brings the account current.

The range of products offered through companies regarded as BNPL providers is constantly growing, and — sometimes as part of a bank partnership— now includes charge cards, interest-bearing closed-end loans, and direct-debit, noncredit payment products. Enabling in-store purchases has become an important focus for BNPL companies, variable downpayment percentages are more common, and some previously "free" products now include origination charges and other fees.

BNPL experienced massive growth during the height of the pandemic, and in 2020, the CFPB began an information-gathering process, culminating in December 2021 marketing monitor orders issued to five of the largest BNPL providers. The CFPB followed up with a September 2022 report on market trends and consumer impacts in the BNPL space, signaling increased scrutiny of the BNPL industry.

More recently, in March 2023, the CFPB issued a report exploring the financial profiles of BNPL borrowers. On average, the CFPB found that BNPL borrowers were more likely to be highly indebted, revolve on their credit cards, have delinquencies with credit products, have lower credit scores, and use high-interest financial services such as payday, pawn, and overdraft compared to non-BNPL users. In a CFPB press release accompanying that report, Director Rohit Chopra remarked: "Since Buy Now, Pay Later is like other forms of credit, we are working to ensure that borrowers have similar protections and that companies play by similar rules."

The OCC also chimed in, issuing guidance in December 2023 to banks on managing BNPL lending risks. While the OCC acknowledged that BNPL loans can provide consumers with a convenient and relatively low-cost financing alternative, it also described potential risks for both banks and consumers, including the potential for borrowers to overextend themselves or not understand the repayment terms, and underwriting challenges for banks due to a borrower's limited or lack of a credit history. To mitigate these risks, which align with those raised by the CFPB over the past few years, the OCC advised banks engaged in BNPL lending to operate within a risk management system that is commensurate with the associated risks and designed to address the particular characteristics of BNPL loans.

Given that a 2021 marketing monitoring order given to five "big tech" companies led to the CFPB's November 2023 proposal to supervise larger nonbank companies that offer services like digital wallets and payment apps, we expect the CFPB to take steps in 2024 to supervise or more closely regulate BNPL.

Oversight of Banking-as-a-Service (BaaS) and Fintech-Bank Partnerships

In 2023, federal regulators took several significant actions targeting fintech-bank partnerships, including issuing formal guidance on risk management practices for third-party relationships and several enforcement actions.

The Federal Reserve Board (Fed), FDIC, and OCC issued multiagency guidance on risk management practices for third-party relationships that replaced much of each agency's prior guidance. The guidance contemplates banks implementing a risk-based approach to oversight, where sound risk management depends on the risks associated with the specific third-party relationship that accounts for the risk profile and nature of the third-party relationship as well as the bank's size and complexity. This included expressly reaffirming that the risk management principles apply to fintech partnerships. The guidance also focuses on specific aspects of risk management in the third-party relationship life cycle, including planning, due diligence, contract negotiations, ongoing monitoring, and termination, in addition to governance issues. Although the CFPB was not a party to the guidance, the concepts addressed are consistent with [the CFPB's guidance] on oversight of third-party relationships.

In addition to issuing guidance, federal regulators issued several consent orders related to third-party risk management issues. For example, in March the FDIC entered into a consent order with Cross River Bank (CRB), which engages multiple third parties in BaaS partnerships. The FDIC concluded that the bank engaged in unsafe or unsound practices related to fair lending compliance by failing to establish or maintain internal controls, information systems, and prudent credit underwriting practices. The order required CRB to conduct a risk assessment of all credit products and current partnerships, develop internal controls related to future partnerships, and engage in periodic reviews of those partnerships' fair lending compliance practices, among other steps. Although that order related specifically to fair lending issues, the oversight considerations apply more broadly to other areas of compliance as well, especially in the context of the multiagency guidance. As a result, bank partners should expect banks to more closely scrutinize compliance practices at multiple stages of the relationship.

Earned Wage Access State Law Developments

In 2023 state legislators and regulators increased scrutiny of earned wage access (EWA) programs, including in new legislation, regulatory guidance, and proposed regulations. Both Nevada and Missouri passed legislation defining EWA transactions as products that are separate and distinct from consumer credit. To that end, the Nevada and Missouri legislation clarified that EWA products are not subject to credit or lending laws and provide a separate regulatory structure for EWA products. Similarly, regulators in Arizona and Kansas issued guidance clarifying that certain EWA products are not loans under their state laws. However, the Kansas guidance was particularly narrow, as it only addressed EWA products offered directly by employers.

Not all states took this approach. Connecticut significantly amended its Small Loan Act by redefining a covered "small loan" to include an advance of money on a borrower's "future potential source of money, including but not limited to future pay, salary, pension income or tax refund." Although the reference to "future" pay suggests the amended language may not cover advances based on *earned* income, the Connecticut Department of Banking issued guidance expressly clarifying that EWA advances are covered, as they are transactions based on future wages or salary "that have been earned but not yet paid." Maryland's Office of Financial Regulation also issued guidance addressing when an EWA product is a loan for purposes of Maryland's Consumer Loan Law. That guidance clarified that EWA products offered *directly* by employers are not loans but noted that the involvement of a third-party provider could result in the service provider being considered a consumer lender, depending on the facts and circumstances. As a result, Maryland's guidance did not fully clarify how EWA is treated but suggests Maryland's regulator will closely examine programs not offered directly and solely by the employer.

Looking forward to 2024, we expect that state regulatory focus on EWA will continue, because regulations have already been proposed in California and multiple states saw EWA-related legislation introduced but not passed in 2023.

Small-Business Financing State Law Developments

2023 brought additional regulatory attention to the small-business finance market, with additional states imposing disclosure or registration requirements and California defeating a challenge to its disclosure regulations.

Georgia and Florida passed laws imposing disclosure requirements similar to those passed by Utah in 2022. These states require providers of commercial loans, commercial open-end credit plans, or accounts receivable purchase transactions to provide TILA-like disclosures, notably without requiring an APR disclosure. Significantly, although Georgia and Florida's statutes exempt certain depository institutions, Florida's exemption appears limited to state banks with Florida charters and national banks, potentially imposing compliance requirements on non-Florida-chartered state banks.

Connecticut also passed a narrower law requiring providers of sales-based financing transactions to register and provide disclosures. The law is generally similar to Virginia's registration and disclosure law, which was passed in 2022.

Finally, California finalized additional regulations under the California Consumer Financial Protection Law that require providers of commercial financing to file an annual report with the Department of Financial Protection and Innovation. California also obtained summary judgment in a case challenging its commercial financing disclosure requirements. The U.S. District Court for the Central District of California held that the disclosure requirements were not preempted by TILA and did not violate the First Amendment.

We expect to see regulators at the state and federal levels continue to focus on small-business financing in the coming year. ■

MORTGAGE

Contributors: Kyle Deak, Jason Manning, Erin Edwards, Jonathan Kenney, Rachelle Pointdujour, Mark Windham

The past year has seen significant developments in the regulatory and litigation landscape related to mortgage servicing. From enforcement trends in loss mitigation and fee violations to evolving interpretations of debt acceleration and statute of limitations triggers, the industry has faced a myriad of challenges and changes. At the state level, we have seen increased regulation of interest rate caps, licensure requirements, and usurious loans, as well as a concerted effort to tackle hidden or misleading fees. This chapter provides an overview of these developments, offering insights into their implications, as well as a brief look at what to expect in 2024.

Loss Mitigation Enforcement Trends

The Consumer Financial Protection Bureau (CFPB) reported the following Regulation X violations observed in mortgage servicing examinations, which it noted will continue to be a target of supervisory and enforcement efforts:

- Informing consumers that complete loss mitigation applications would be evaluated within 30 days, and then failing to evaluate the application within that time frame;
- Failing to include required loss mitigation language on Spanish language application acknowledgment notices; and
- Failing to provide critical loss mitigation information, specifically:
  - precise denial reasons (versus vague ones, e.g., “the consumer did not meet the eligibility requirements for the program”);
  - correct payment and duration information for forbearance plans; and
  - information in periodic statements about loss mitigation programs to which consumers had agreed (e.g., forbearance programs).

Fee Violation Enforcement Trends

The CFPB devoted an entire special edition of its *Supervisory Highlights* report to so-called “junk fees,” which identified categories of UDAAP and Regulation Z violations pertaining to fees, which received supervisory and enforcement focus:

- Failing to enter loan-specific late fee caps into servicing systems, causing consumers to be charged the maximum allowable late fees under relevant state laws;
- Charging for repeat property inspections after inspectors had reported the addresses were incorrect and the properties could not be located;
- Sending monthly periodic statements and escrow disclosures that included private mortgage insurance (PMI) premiums when the loans were originated with lender-paid PMI; and
- Failing to waive certain charges when consumers entered permanent loss mitigation options under the CARES Act.

Debt Acceleration and Statute of Limitations Triggers

- The Colorado Supreme Court in *U.S. Bank National Association v. Silvernagel* as well as the Washington Supreme Court in *Copper Creek (Marysville) Homeowners Association v. Kurtz* and *Merritt v. USAA Federal Savings Bank* held that a borrower’s bankruptcy discharge does not accelerate secured installment debt or trigger the final statute of limitations period to recover the debt through foreclosure. Promissory notes or deeds of trust with optional acceleration clauses allow a lender to accelerate any future payments’ due date, but the lender must perform some clear, unequivocal affirmative act evidencing its intention to take advantage of the acceleration provision. As confirmed by the states’ supreme court opinions, a borrower’s bankruptcy discharge does not constitute a clear, unequivocal affirmative act evidencing the lender’s intent to accelerate.

- In *Bridges v. Nationstar Mortgage LLC*, the Arizona Supreme Court held that recording a notice of trustee's sale does not evidence a secured installment debt's acceleration and does not trigger the final statute of limitations period to enforce the debt.

State-Level Trends

- Some states aimed to increase regulation of interest rate caps, licensure requirements, and usurious loans. On June 29, Connecticut Governor Ned Lamont signed Substitute Senate Bill 1033, which makes significant changes to the state's Small Loan Act (SLA) which aimed to set strict rate caps on consumer loans. The law further eliminates a requirement that certain persons demonstrate an ability to supervise mortgage servicing offices in person.
- Nebraska's Legislative Bill 92 expands the scope of the licensing requirement for a lender seeking to take advantage of the usury authority provided by the Nebraska Installment Loan Act (NILA). Previously, a license was required for a lender seeking to take advantage of the usury authority and for any person who holds any rights of participation in a loan under the NILA. The new law includes "any person that is not a financial institution who, at or after the time a [covered] loan is made by a financial institution, markets, owns in whole or in part, holds, acquires, services, or otherwise participates in such loan."
- California has focused its efforts on tackling hidden or misleading fees. On October 9, California Senate Bill 478 was passed, prohibiting hidden fees effective July 1, 2024.
- On the litigation front, in *Soaring Pine Capital Real Estate & Debt Fund II, LLC v. Park Street Group Realty Services, LLC*, the Michigan Supreme Court considered whether a court may enforce a usury savings clause in a mortgage agreement. The court found that such a clause is ineffective and contrary to public policy, even if the interest is labeled as a "fee" or "charge."

Looking Forward to 2024

- On November 13, the CFPB and the Federal Reserve Board (Fed) announced increased dollar thresholds used to determine whether certain consumer credit and lease transactions in 2024 are exempt from Regulation Z and Regulation M. Based on the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), Regulation Z and Regulation M generally will apply to consumer credit transactions and consumer leases of $69,500 or less, in 2024, compared to $66,400 or less in 2023. Transactions at or below the thresholds are subject to regulation protection. However, private education loans and loans secured by real property, such as mortgages, are subject to Regulation Z regardless of the loan amount. The CFPB and Fed also announced that the 2024 threshold for exempting loans from special appraisal requirements will increase from $31,000 to $32,400.
- The CFPB has issued a final rule adjusting the Truth in Lending Act dollar amounts for certain provisions, including under the Home Ownership and Equity Protection Act of 1994 and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), where appropriate, based on the annual percentage change reflected in the consumer price index, effective January 1, 2024.
- On June 21, various government agencies published a proposed rule with request for public comment that would implement quality control standards mandated by the Dodd-Frank Act. The standards would require mortgage originators and secondary market insurers that use AVMs to determine the value of mortgage collateral adhere to quality control standards designed to 1) ensure a high level of confidence in the estimates, 2) protect against the manipulation of data, 3) avoid conflicts of interest, 4) require random sample testing and reviews, and 5) comply with applicable nondiscrimination laws. ■

PAYMENT PROCESSING AND CARDS

Contributors: Jason Cover, Mark Furletti, Taylor Gess, Melanie Griffith, Josh McBeain

Introduction

The past year saw payments-related developments continue apace, with particular attention to the fees charged for services. Let's look at some of the most important developments, with an eye toward what this sector can expect in 2024.

FedNow Service

On July 20, 2023, the Federal Reserve launched FedNow Service, an instant payments platform that banks and credit unions can participate in to allow their customers to instantly transfer (or "push") money to other consumers, businesses, or their accounts at other financial institutions. However, it does not currently allow a user to "pull" a payment or otherwise debit another user's account. Payments processed using the FedNow Service are settled on a gross basis, which allows payments to be settled instantly 24/7/365. Optional features in the first release of the FedNow Service include fraud prevention tools, the ability to join initially as a receive-only participant, a request for payment capability, and tools to support participants in their handling of payment inquiries, with additional features and enhancements expected over time.

We anticipate FedNow Service participants, users, and regulators collaborating to address risks related to fraud, money laundering, and misdirected payments.

Digital Wallet Provider Proposed Supervision

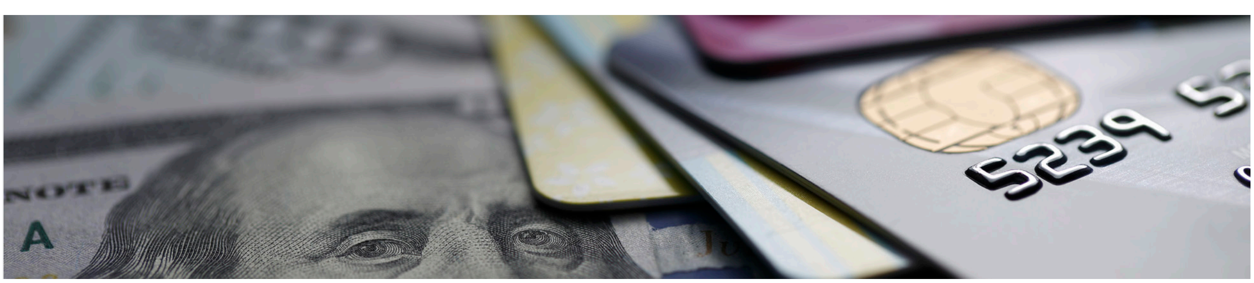
On November 7, 2023, the CFPB proposed a new rule that would subject nonbank larger participants providing general-use consumer digital payment applications to CFPB supervision and examination. Specifically, the CFPB seeks to supervise nonbanks that facilitate transactions through "general-use consumer digital payment applications." That complex definition has four prongs: (1) a covered payment functionality, (2) provided through a digital application, (3) for consumers' general use, (4) in making consumer payment transactions.

The proposed rule followed September 2023 comments from CFPB Director Rohit Chopra discussing the critical role that "big tech" plays in the evolving payments market. Those comments were critical of the "outsized influence" that large tech companies play in the market, especially regarding the "tap to pay" ecosystem. director Chopra noted that one tech company's policies limited consumer choice by prohibiting third-party apps from accessing the tap-to-pay technology and also required card issuers to pay a fee. The Director expressed concern about the "roadblocks" those restrictions and others created for a more open payments ecosystem and that big tech firms could act as "mini-governments that can privately regulate markets and distort outcomes." Clearly the CFPB intends to carefully scrutinize the role large fintech companies play in the evolving payments market.

The proposed rule would apply to providers that facilitate at least 5 million consumer payment transactions per year and that are not considered "small business concerns" by the Small Business Administration.

"Junk Fees" and Automatic Renewal Charges

One of the major focuses for the CFPB and FTC in 2023 was limiting so-called "junk fees," especially those assessed for late payments, repossession,



payment processing, and overdrafts for bank account deposits. A special edition of the CFPB's Supervisory Highlights was dedicated to junk fees, and the FTC proposed a new rule that would require businesses to include all mandatory fees when telling consumers a price and prohibit sellers from misrepresenting fees.

Along with fee regulation, the two agencies also took aim at "negative option" subscription services, where consumers are charged for subscriptions unless they take affirmative action to cancel them. The CFPB asserted in a circular that it may be an unfair, deceptive, or abusive act or practice (UDAAP) for such automatic renewal models to misrepresent or fail to clearly disclose the material terms of the program; fail to obtain consumers' informed consent; or mislead consumers who want to cancel, erect unreasonable barriers to cancellation, or fail to honor cancellation requests. The FTC proposed changes to its Negative Option Rule, which would increase the coverage of the rule to include all forms of negative option marketing, require businesses to make it as easy to cancel a subscription as it was to sign up for it, and require sellers of services to provide annual reminders to consumers before their subscriptions are automatically renewed.

States have also begun more broadly regulating fees and automatic renewal plans this year. As of July 1, 2024, California will prohibit advertising, displaying, or offering a price for a good or service that does not disclose all mandatory fees or charges other than taxes or fees imposed by the government. Companies that don't comply with the new law could face steep penalties. Recently, the Massachusetts attorney general proposed regulations that would require businesses to clearly disclose the total price of a product at the time it is presented to consumers, provide clear and accessible information on whether fees are optional or required, and simplify the process for canceling trial offers and recurring charges.

These regulations are part of the ongoing efforts of regulators to combat "dark patterns" (i.e., website design features allegedly used to trick or trap consumers).

Credit Card Late Fee Rulemaking

Regulation Z limits the amount that a credit card issuer may charge for late payments. The regulation requires an issuer to determine that the dollar amount of the late fee is "reasonable and proportional to the omission or violation" of paying late. Regulation Z also provides a "safe harbor" provision that allows credit card issuers to avoid enforcement scrutiny if they charge the "safe harbor" late fee amounts, which are set to adjust annually based on changes in the consumer price index. The current safe harbor late fee limits are $30 for the first late payment and $41 for subsequent late payments. The CFPB proposed to cut Regulation Z's safe harbor to $8 per violation with no increased fee allowed for subsequent violations and no annual adjustments for inflation. Under the proposed rule, late fees would also be limited to a maximum of 25% of the required minimum payment. In conjunction with the credit card late fee rulemaking, the CFPB also solicited comment on other potential Regulation Z fee-related changes.

Competition in Debit Card Payment Market

The FTC finalized a consent order with a major payment processing network over charges that it used illegal business tactics to force merchants to route debit card payments through its payment network. The FTC alleged that the payment processor prevented merchants from using competing networks to process certain e-commerce debit payments in violation of the Durbin Amendment, which requires banks to enable at least two unaffiliated networks on every debit card. The Durbin Amendment gives merchants a choice of which network to use for a given debit transaction and bars payment card networks from inhibiting merchants from using other networks. Under the order, the payment network must begin providing competing networks with the customer account information needed to process payments.

Looking Forward

We expect regulatory scrutiny of emerging payment technology — including digital payment applications — to continue as such technology becomes more ubiquitous. The "war on fees" is likely to continue raging into 2024 and beyond, along with scrutiny of "dark patterns" and other program features that regulators deem misleading to consumers. ■

SMALL-DOLLAR LENDING

Contributors: Jason Cover, Mark Furletti, Taylor Gess, Melanie Griffith, Josh McBeain

Introduction

Small-dollar lending continued an upward trend in 2023, and so did federal and state regulatory activity. In this chapter, we examine state efforts to opt out of certain sections of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) and changes to several state lending laws. We also explore ongoing litigation in California concerning "true lender" issues, the status of the CFPB's Payday Lending Rule, and the latest supervisory highlights from the CFPB. Finally, we look ahead to potential future regulatory changes and their implications for the industry.

State Law Developments

Colorado joined Iowa and Puerto Rico as states exercising their authority under section 525 of DIDMCA to opt out of sections 521 to 523, which respectively empower state-chartered FDIC-insured banks, savings associations, and credit unions to charge the interest allowed by the state where the financial institutions are located, regardless of where the borrower is located and regardless of conflicting state law (i.e., "export" their home state's interest-rate authority). (National banks have comparable authority under 12 U.S.C. § 85 and are not subject to DIDMCA or the Colorado opt-out.) The opt-out, effective July 1, 2024, intends to limit the charges that can be imposed by covered out-of-state depository institutions making loans to Colorado residents. For example, all state-chartered banks doing business in Colorado will have the finance charge on loans capped between 15% and 36% per year, depending on the amount financed, or a 21% flat rate of finance charge.

By purporting to limit rates on interstate loans to Colorado residents, the Colorado opt-out may result in reduced access to online credit to Colorado residents. The opt-out also might not be effective for its intended purpose. In this regard, in *Stoorman v. Greenwood Trust*, a Colorado appellate court held that a prior Colorado opt-out from sections 521-523 did not apply to credit card transactions between out-of-state state banks and Colorado residents because the transactions were not "made" in Colorado as required for the opt-out to apply (i.e., they were instead "made" in the bank's state). 888 P.2d 289, 293-294 (Colo. App. 1994), aff'd, 908 P.2d 133 (Colo. 1995) (en banc). Other federal precedent relating to interest rate exportation supports the conclusion that, so long as the bank appropriately establishes the loan program, when analyzing whether an opt-out should apply, loans are made in the out-of-state depository institution's location, not the borrower's state. FDIC Dep. Gen. Counsel Mem., FDIC-88-45 (June 29, 1988).

Small-Loan Acts: Connecticut amended its Small Loan Law, Minnesota amended its consumer short-term loan and consumer small-loan provisions, and Florida proposed amendments to its Consumer Finance Act.

In Connecticut, the small-loan limit was raised from $15,000 to $50,000, the APR on loans of $5,000 to $50,000 was limited to 25%, the APR is "all in" and includes virtually all fees, and licensure is now required for certain brokering and facilitating activities. Income sharing agreements (ISAs), refund anticipation loans, and pension advances are now expressly covered by the Act, and it likely now applies to other popular small-dollar lending models such as earned wage access programs, membership programs, and 0% APR programs with tips and expedited funding or similar fees, as discussed more in the Fintech section of this report.

The Minnesota amendments, effective January 1, 2024, cap the all-in APR at 50%, codify an anti-evasion provision, and require an ability-to-pay analysis for "consumer small loans" and "consumer short-term loans" with all-in APRs exceeding 36%. The law defines "consumer short-term loan" as a loan to a borrower that has a principal amount, or an advance on a credit limit, of $1,300 or less and requires a minimum payment of more than 25% of the principal balance or credit advance within 60 days. The law defines "consumer small loan" as a consumer-purpose unsecured loan equal to or less than $350 that must be repaid in a single installment. These statutes have typically been used to offer payday or similar short-term small-dollar loans, and it is not entirely clear whether the anti-evasion provision will be applied narrowly within the confines of these defined terms or if it might instead be applied more broadly to longer-term loans with all-in APRs above 36%.

All three states codified or proposed to codify "predominant economic interest" and "totality of the circumstances" tests for "true lender" purposes. The Florida bill would likewise treat an agent or servicer as the lender if it both (1) markets, solicits, brokers, arranges, facilitates, or services a covered loan and (2) holds or has the right, requirement, or right of refusal to acquire the loan or another direct or indirect interest in the loan, even if another party has a much larger economic stake.

All three states codified or proposed to codify "predominant economic interest" and "totality of the circumstances" tests for "true lender" purposes.

Nebraska Installment Loan Act: In August, Nebraska Governor Jim Pillen signed an amendment to the state's Installment Loan Act expanding the licensing requirement to cover "any person that is not a financial institution who, at or after the time a [covered] loan is made by a financial institution, markets, owns in whole or in part, holds, acquires, services, or otherwise participates in such loan." The licensing requirement, by its terms, applies to entities providing limited services and/or purchasing limited interests (not just the predominant economic interest) in loans by financial institutions of $25,000 or less with rates exceeding the Nebraska general usury limit.

California "True Lender" Litigation: On October 30, 2023, a California state court denied a preliminary injunction sought by the California Department of Financial Protection and Innovation (DFPI) in its long-running litigation against Opportunity Financial (OppFi) contending that OppFi is the "true lender," and therefore subject to usury limits, on loans originated by OppFi's bank partner.

OppFi's online platform allows its bank partner, FinWise Bank, to make short-term loans to higher-risk consumers. California has an interest rate cap of 36% plus the federal funds rate on consumer loans between $2,500 and $9,999 for lenders licensed under the California Financing Law (CFL). Interest on the FinWise loans exceeds that cap, but banks are exempt from the CFL and California's usury limits generally. FinWise also has the right, under section 27 of the Federal Deposit Insurance Act, to export the usury law of its home state, Utah, which does not impose a usury limit. In moving for a preliminary injunction, the DFPI nevertheless charged that OppFi is violating the CFL because it, rather than FinWise, is the "true lender" on the loans.

In denying the DFPI's motion, the court first noted that "[i]n determining whether a particular transaction is usurious," a California court looks to the transaction's "substance rather than to its form." But the question to be answered, according to the court, was only whether the form of the transaction "was a mere sham and subterfuge to cover up a usurious transaction."

The court held that "the [DFPI] has not sufficiently shown that the OppFi-FinWise partnership was a mere sham and subterfuge," because FinWise, among other things:

- Uses its own funds to originate the loans, from accounts it controls;
- Retains title and ownership of the loans throughout the life of the loan, selling only loan receivables (the right to payments on the loans) to an OppFi affiliate (which in turn sells those receivables to outside investors) within days of origination;
- Retains a 5% interest in the loan receivables; and
- Collects a percentage fee on each of the loans.

In pressing its “true lender” argument, the DFPI argued that OppFi controls the underwriting process, relying heavily on statements in OppFi’s 10-K indicating that OppFi uses its technology to provide AI-powered underwriting services to its bank partners, including FinWise. The court found those statements “insufficient” given that the 10-K also explained that “the [underwriting] algorithm used by the AI is ‘bank-approved’” and that “OppFi’s proprietary algorithms are validated by bank partners to facilitate their underwriting.” An officer of FinWise testified that the bank maintains oversight over compliance and proprietary credit models that are developed by OppFi. OppFi also submitted testimony that FinWise “places the largest amount of funds at risk when funding and it continues to be exposed to economic upside and downside risk through its retention of a receivable interest.”

The court also gave little if any weight to the DFPI’s argument that OppFi was the “true lender” because “OppFi has a prearrangement to purchase” approximately 95% of loan receivables. The court found that this aspect of the bank partnership “seem[s] … consistent with FinWise’s right to assign, sell, or otherwise transfer its loans to OppFi” under a 2020 FDIC regulation, which provides that whether interest is permissible is determined as of the date the loan was made and is not affected by sale, assignment or other transfer of the loan. The court thus reasoned that “[t]o the extent ‘FinWise-originated’ [loans] had permissible interest rates at the time the loans were made, the fact that the bank sold, assigned, or otherwise transferred the loans to OppFi should not make the loans usurious.”

With respect to the FDIC regulation, the court further opined that the DFPI’s true-lender theory might be preempted under the doctrine of “obstacle preemption.” The court explained that if it “were to interpret the [CFL] to mean that FinWise was not a ‘true lender’ for exemption purposes because the bank decided to assign, sell, or otherwise transfer [loans] to OppFi, … that ruling may stand as an obstacle to the full purposes and objectives of Congress.”

Of course, this decision bodes well for OppFi’s future prospects in trial court. We will continue to closely monitor this case.

Payday Lending Rule

In 2017, the CFPB promulgated a rule regulating “payday, vehicle title and certain high-cost installment loans” (Payday Rule). (Despite its name, the Payday Rule potentially applies broadly to a variety of credit products, including low- or no-APR products payable in 90 days or less and certain open-end credit products.) While the Payday Rule’s most onerous provisions — those related to ability to repay — have been rescinded, certain payment-related provisions remain, including provisions that (1) prohibit covered lenders from initiating additional payment transfers from consumers’ accounts after two consecutive failed payment attempts have failed for insufficient funds unless the consumer authorizes additional payment transfers and (2) require various notices before a covered lender initiates a payment transfer attempt.

The Community Financial Services Association of America and the Consumer Service Alliance of Texas filed a lawsuit against the CFPB in 2018 challenging the validity of the payment provision in the Payday Rule and the CFPB’s funding mechanism. The case was litigated for years, and in 2022 the Fifth Circuit held that the CFPB’s funding mechanism is unconstitutional because the CFPB does not receive its funding from annual congressional appropriations like most executive agencies but instead receives funding directly from the Federal Reserve based on a request by the CFPB’s director. The CFPB appealed to the U.S. Supreme Court. Argument was held in October, and a ruling is expected in the first or second quarter of 2024.

The effective date of the Payday Rule has already passed and, but for a court-ordered stay, would currently apply to covered lenders. Given that the Fifth Circuit failed to find issue with the Payday Rule or the CFPB’s rulemaking — only the constitutionality of the CFPB itself — a ruling adverse to the CFSA is likely to result in the eventual enforcement of the rule.

Supervisory Highlights

The CFPB noted in its July 2023 Supervisory Highlights issues identified during examinations of payday and small-dollar lenders. The CFPB

identified multiple unfair, deceptive, and abusive acts or practices associated with lenders' debt collections practices, including (1) limiting consumers' ability to revoke their consent for the lender to call, text, or email the consumer, which implied that the consumer could not limit unwanted debt collection communications; (2) making false collection threats related to litigation, garnishment, and late fees; (3) unauthorized wage deductions for amounts larger than the consumer authorized; and (4) misrepresenting the impact that payment or nonpayment of debts in collection may have on the sale of the debt to a debt buyer and the subsequent impact on the borrower's credit reports.

The CFPB also identified that lenders created a risk of harm to borrowers protected by the Military Lending Act when they failed to confirm whether an applicant was a "covered borrower" under the Act before origination. The risks to consumers included potentially originating loans to covered borrowers at rates and terms impermissible under the Act, not providing covered borrowers with required disclosures, including prohibited mandatory arbitration clauses in loan agreements, and failing to limit certain types of repeat or extended borrowing.

Looking Forward

Further state regulation of bank model lending may continue. As shown by the OppFi litigation in California, challenges to this type of state regulation by bank program facilitators and bank partners is needed to curb the increase in regulation.

While predicting outcomes based on U.S. Supreme Court oral arguments is an imprecise art, many observers believe the CFPB will prevail. If this prediction is correct, we anticipate the Payday Rule's enforcement date will align with the current stay (i.e., 286 days after the appeal is decided. Of course, if the Supreme Court affirms the Fifth Circuit's decision, the future of the CFPB, as well as all of its rulemakings and enforcement actions to date, would be in question).

We expect continued federal regulatory pressure, such as the CFPB's focus on small-dollar lenders, particularly depending on the outcome of the 2024 election. ■

STUDENT LENDING

Contributors: Dave Gettings, Courtney Hitchcock

After a pandemic-related hiatus of several years, student lending began a contentious — and litigious — return to normalcy in 2023. With the nation's focus on ballooning student debt balances, student lending remains a politically charged area with an uncertain future following the Supreme Court's decision to strike down the Biden administration's loan forgiveness plan. We also saw federal courts weigh in on how to report student loans during a Coronavirus Aid, Relief, and Economic Security Act (CARES Act) forbearance. Student loan discharge through personal bankruptcy also remained a frequently addressed topic, with the CFPB addressing servicers who attempt to collect on student loans that were successfully discharged.

Student Lending Decisions

Courts across the country issued several major decisions on student lending in 2023, addressing questions ranging from the effect of bankruptcy discharges on student loan reporting requirements to the president's ability to cancel student loans.

No decision in 2023 was more impactful to student lending than the Supreme Court's holdings in *Biden v. Nebraska*, 143 S. Ct. 2355 (2023). The central issue in *Biden v. Nebraska* was whether the secretary of education had authority under the Higher Education Relief Opportunities for Students Act of 2003 (HEROES Act) to establish a program canceling approximately $430 billion in student loan debt. After concluding that Missouri had standing to bring suit through means of the Missouri Higher Education Loan Authority (MOHELA), the court held that the statutory language of the HEROES Act did not authorize the loan forgiveness program.

In reaching its holding, the court looked to the text of the statute — and specifically to the secretary of education's power to "waive or modify" existing provisions applying to financial assistance programs established by the Higher Education Act of 1965. The court reasoned that modification, by definition, implied a moderate or minor change and that it was highly unlikely Congress intended to allow for a general discharge like the one the Secretary of Education promulgated.

The court also found that the secretary did not have the authority to implement mass student loan cancellation via "waiver" powers. The court reasoned that the debt cancellation plan was not a waiver because the plan drastically augmented and expanded existing provisions of law and distorted the fundamental nature of those provisions.

Despite this setback, the Biden administration continues to advocate for student debt relief. In early December 2023, the Department of Education announced the approval of an additional $5 billion in student loan cancellation through existing loan forgiveness programs, adding to the substantial balance forgiven under the Biden Administration.

Other federal courts also weighed in on a variety of student lending topics in 2023.

In *Mader v. Experian Info. Sols., Inc.*, 56 F.4th 264 (2nd Cir. 2023), the plaintiff obtained a private student loan in 2008, which was assigned to a new loan owner. The plaintiff filed for bankruptcy in 2012, and was discharged in 2013. The loan's new owner maintained that the student loan was not discharged, and the parties entered into a loan modification agreement. The plaintiff paid the loan until 2017, then stopped. The plaintiff's January 2019 credit report reflected a remaining balance of $20,890 with a past due balance of $8,519, and it also noted the loan modification agreement. The plaintiff sued the consumer reporting agency under the Fair Credit Reporting Act (FCRA) for reporting the debt. The court granted the consumer reporting agency's motion for summary judgment, holding that there was no inaccuracy under the FCRA where the accuracy of the reporting hinged on an undecided question of law. In this case, the undecided question was whether the plaintiff's student loans were actually discharged in his bankruptcy because the bankruptcy court did not address that issue.

In *Hafze v. Equifax Info. Services, LLC*, No. 20-9019 (JXN) (JRA), 2023 WL 2728805 (D. N.J. Mar. 31, 2023), the plaintiff brought a lawsuit for alleged FCRA violations stemming from the consumer reporting agency's reporting of her student loans as in CARES Act forbearance when they should have instead been reported consistent with their pre-CARES Act status. The court held that the FCRA did not prohibit CRAs from including forbearance language in their reports and granted the consumer reporting agency's motion to dismiss.

CFPB Focus on Student Lending

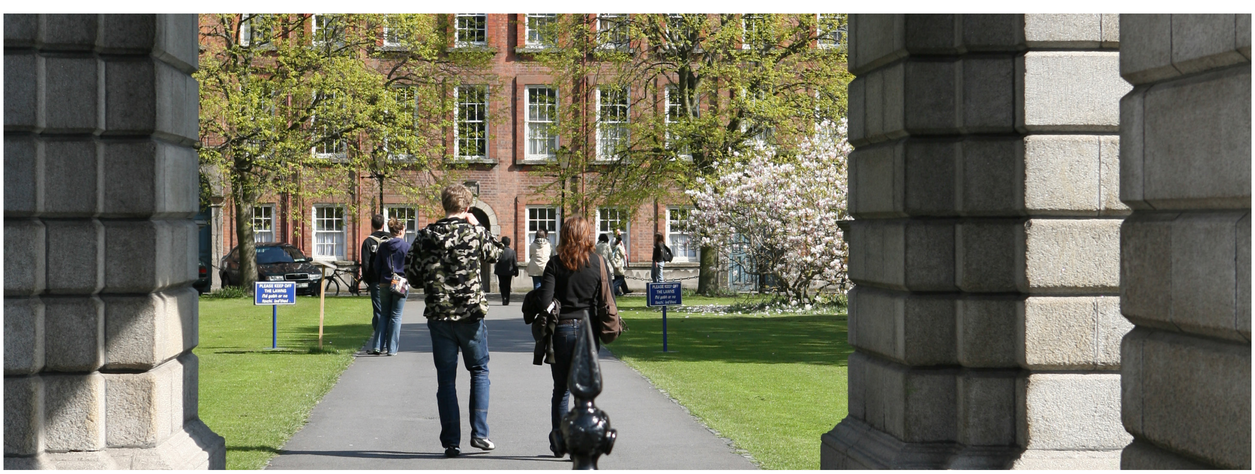
The CFPB also weighed in on student lending in 2023, publishing Bulletin 2023-01, "Unfair Billing and Collection Practices After Bankruptcy Discharges of Certain Student Loan Debts," on March 16, 2023. This bulletin notified student loan servicers that the CFPB intended to exercise its enforcement and supervisory authorities, declaring that servicers that collected on loans properly discharged in bankruptcy engaged in unfair, deceptive, or abusive acts or practices in violation of the Consumer Financial Protection Act (CFPA).

The CFPB also issued a report on September 14, 2023, titled "Tuition Payment Plans in Higher Education." This report detailed the types of school-provided tuition payment plans available to students and outlined the risks to the student consumers. The report concluded that school-provided tuition payment plans may lead to issues that do not exist in federal student lending, such as a potential captive market, debt accumulations, and disenrollment.

Enforcement against private student lenders also remained a focus for the CFPB. The Bureau filed an adversary proceeding in bankruptcy court against a private student lender that offered loans to students via an "income share agreement," under which the students would pay between 12.5% and 16% of their gross income to the lender for four to eight years, or until $30,000 was paid. The complaint alleged violations of the CFPA, the Truth in Lending Act (TILA), and the Fair Debt Collection Practices Act (FDCPA). The parties entered into a judgment and stipulation requiring the lender to cease business activities, restricting the lender's use of customer information, voiding all outstanding income share agreement contracts, imposing a monetary judgment totaling $4,248,249.30 (to redress impacted customers), and ordering other monetary penalties.

Moving Forward

Student lending remained a volatile area in 2023, and this trend is likely to continue into 2024. Despite setbacks in the Supreme Court, the Biden administration seems committed to alternate forms of debt forgiveness to indebted students. The bankruptcy courts remain an active forum for student lending litigation, which may increase as more student loan repayments resume in late 2023 and 2024. With uncertainty hanging over future developments, a promise of increased enforcement against private servicers allegedly engaging in unfair practices, and a contentious election year approaching, expect student lending to remain an active area in 2024. ■



TELEPHONE CONSUMER PROTECTION ACT

Contributors: Virginia Flynn, Chad Fuller, Susan Nikdel, Sara Siu, Jovanni Villa

The Telephone Consumer Protection Act (TCPA) continues to be a favorite target for the plaintiffs' bar, with TCPA filings up 11.5% year to date over 2022 as of early November. Standing, autodialers, prerecorded messages, consent revocation, and lead generators continued to be hot topics for courts and regulators in 2023.

Developments in Litigation

Post-*Facebook*

In *Facebook v. Duguid*, the U.S. Supreme Court clarified that under the TCPA an automatic telephone dialing system (ATDS) must have the capacity to store or produce a telephone number using a random or sequential number generator to qualify as an ATDS. In 2023, courts across the country have continued their interpretation of what constitutes an ATDS, and while the results remain somewhat mixed, a majority of federal courts have adopted the narrow *Facebook* definition. Notably, the Eastern District of Pennsylvania in *Perrong v. Bradford* began its analysis of whether the system qualified as an ATDS with a thoughtful summary of *Facebook* and concluded that a system only qualifies as an ATDS if it generates the telephone numbers dialed rather than simply choosing numbers to call off an imported list. On the other hand, in *Smith v. Vision Solar LLC* the plaintiff's expert testified that the dialing system at issue used a random or sequential number generator because "[i]t used it first to load the list into — or put the list into memory. It used it again to call the list as well." Based on this testimony, the court found a triable issue existed not only as to whether the defendant's dialing system had the capacity to call using a random or sequential number generator, but also as to whether that capacity was actually used to place calls in the given case.

Prerecorded Message and Text Message Litigation

While autodialer litigation has slowed following the *Facebook v. Duguid* decision, prerecorded messages continue to provide substantial fodder for plaintiffs. In a positive ruling for defendants,

The court was not swayed by the plaintiff's attempt to analogize the text to a voicemail left to be played later, because "voicemails are the result of voice calls, not text messages."

however, the Ninth Circuit recently rejected yet another effort to extend prerecorded message rules to text messages, ruling that a prerecorded message must include "audible components." In *Trim v. Reward Zone USA LLC*, the plaintiff brought a class action arguing that marketing text messages sent without her prior consent were prerecorded "voice" messages because "voice" could be defined to mean "an instrument or medium of expression." The district court disagreed, dismissing that count, and the Ninth Circuit affirmed. The Ninth Circuit rejected that argument, holding that the statute unambiguously uses "voice" to refer only to "audible sounds."

Two months later, the Federal District Court for the District of Arizona, in *Howard v. Republican National Committee*, rejected another plaintiff's argument that a text message containing a video link with an audio component constituted a prerecorded message. The court was not swayed by the plaintiff's attempt to analogize the text to a voicemail left to be played later, because "voicemails are the result of voice calls, not text messages." The court ultimately found the fact that the video did not play automatically to be dispositive, because the text did not have an audible component that was "thrust upon the recipient" as required by the Ninth Circuit.

Standing

The Ninth Circuit recently ruled that the receipt of an unsolicited text message or phone call to a number listed on the do-not-call registry is sufficient to confer Article III standing under the TCPA, even if the individual is not the primary user of the phone. This ruling, in *Kristen Hall v. Smosh Dot Com Inc.*, curtails defenses based on lack of standing in TCPA cases. However, the court left open the question of whether a subscriber would have standing if they authorized a third-party user to provide consent to receive telemarketing. The ruling emphasizes the importance for companies to have up-to-date do-not-call registry lists, clear opt-in and opt-out methods, and TCPA-compliant business texting software.

Developments in Regulatory Oversight

FCC Proposed Rules Regarding Lead Generators

Courts, litigants, and now federal agencies have also been taking a closer look at the use of lead generation websites to gather consent for marketing calls and texts. Most recently, at its December open meeting the Federal Communications Commission (FCC) adopted new rules that will prohibit comparison-shopping websites and other telemarketers from obtaining consent on behalf of another company except on a one-to-one basis. The rule prohibits the use of hyperlinked lists of “marketing partners” to obtain leads for multiple companies at once and would require that any consents be both “clear and conspicuous” and “logically and topically related” to the website’s subject matter. The rule will become effective 12 months after publication in the Federal Register.

FCC Proposed Rules Regarding Revocation

On June 29, 2023, the FCC issued a notice of proposed rulemaking clarifying how consumers may revoke consent to receive calls or texts under the TCPA. The FCC requested comments on three issues: (1) revocation of consent in any reasonable way, (2) sending revocation confirmation text messages, and (3) wireless subscribers’ ability to revoke consent to receive notices from their provider.

First, the FCC proposed to codify its 2015 ruling that a consumer may revoke prior express consent to receive autodialed or prerecorded voice calls through any reasonable means. Per the FCC’s commentary, revocation could be done by text message, voicemail, or email to any telephone number or email address where the consumer can reasonably expect to reach the caller. In doing so, it would create a rebuttal presumption that the consumer has revoked consent in a reasonable way. Second, the FCC further proposed to codify its prior ruling that a one-time text message confirming a consumer’s request for no further text messages does not violate the TCPA, provided the message only confirms the opt-out request and does not include any marketing or promotional information. Lastly, the FCC proposed to narrow a prior ruling, providing that wireless carries did not need to obtain prior express consent to send messages to their subscribers if the subscribers are not charged, by limiting the exemption to apply only if certain conditions are satisfied.

Seven State Attorneys General (AGs) Announce Settlement With Robocallers

On August 16, 2023, a coalition of seven state attorneys general (AG) announced a settlement with participants alleged to be involved in a “massive” robocall operation. The stipulated order permanently bans the individual defendants, and their companies, from engaging in robocall-related activities in the plaintiffs’ states. It also bans them from engaging in lead generation or telemarketing for 10 years in the plaintiffs’ states and from engaging in such activities nationwide for two years. The order also includes a $73,076,930 monetary judgment, but only requires one defendant to pay $250,000. The remainder of the monetary judgment is suspended due to the defendants’ financial situation. The defendants’ settlement demonstrates that it is essential to monitor the regulatory environment and to adjust business practices to minimize risk.

Looking Forward

Expect to see regulators continue to tighten perceived loopholes in gathering and revoking consent. On the litigation front, prerecorded calls and do-not-call list violations will likely continue to be popular targets for class action suits. ■

TRIBAL LENDING

Contributors: David Anthony, Scott Kelly, Jed Komisin, Meagan Mihalko

Lawsuits challenging Tribal lending practices continued in 2023. Sovereign immunity received significant attention, with (1) the U.S. Supreme Court determining the Bankruptcy Code abrogates federally recognized Indian Tribes' immunity in certain instances, and (2) the Seventh Circuit adopting the *Breakthrough factors*, finding that an economic arm was entitled to immunity and that individual defendants were entitled to immunity, despite personal capacity allegations. Courts continued to scrutinize the enforceability of loan terms, with the Fourth Circuit extending the prospective waiver doctrine to invalidate a class action waiver, while the Southern District of California granted a non-Tribal defendant's motion to compel arbitration.

Finally, following a Ninth Circuit appeal, the Central District of California analyzed the CFPB's ability to secure elevated civil penalties against a Tribal lending entity and its CEO based on the court's finding that the Consumer Financial Protection Act (CFPA) violations were so obvious that they justified elevated penalties.

Sovereign Immunity for Tribal Arms and Lenders — U.S. Supreme Court and Seventh Circuit Rule on Applicability

Effect of Bankruptcy on Sovereign Immunity

In *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, the U.S. Supreme Court resolved a circuit split, finding "the Bankruptcy Code unambiguously abrogates the sovereign immunity of all governments, including federally recognized Indian [T]ribes." The Court found:

- Section 106(a) of the Bankruptcy Code abrogates sovereign immunity of "governmental unit[s]" for certain enumerated purposes.
- Section 101(27)'s definition of "'governmental unit' exudes comprehensiveness from beginning to end" and indicates Congress' intent to abrogate the sovereign immunity of any governmental unit.
- As a result, the consumer could enforce the bankruptcy court's automatic stay against the lender and Tribe — which had continued debt collection practices after the consumer filed

for bankruptcy. Tribes and their arms must now pay attention to consumer bankruptcy activity, including relevant bankruptcy stays, and should adjust their collection activity accordingly.

Sovereign Immunity and the False Claims Act

In *Mestek v. Lac Courte Oreilles Community Health Center*, the Seventh Circuit (1) declined to find the False Claims Act (FCA) abrogated sovereign immunity, (2) adopted the Breakthrough factors[1] in assessing whether an entity shares in the Tribe's immunity, and (3) found individual defendants were entitled to sovereign immunity (despite personal capacity allegations). The Seventh Circuit stated:

- Comparing the U.S. Supreme Court's analysis of the Bankruptcy Code in *Coughlin*, the Seventh Circuit did not find the FCA contained a similar "catch-all abrogation."
- The court relied heavily on the Tribe's judicial code in determining the five Breakthrough factors weighed in favor of finding immunity.
- Allegations which will "require action by the sovereign or disturb the sovereign's property" are not personal capacity allegations and are precluded by immunity, despite the plaintiff lodging personal capacity allegations in a complaint.
  - In finding the individual defendants were entitled to sovereign immunity, the Seventh Circuit emphasized that district courts may not simply rely on the complaint's characterization of the remedy sought.

Arbitration and Class Action Waivers

Fourth Circuit Invalidates a Class Action Waiver Based on the Prospective Waiver Doctrine

In *Williams v. Martorello*, the Fourth Circuit declined to enforce the class action waiver in a consumer's loan agreement because:

- The loan agreement only extended the class waiver to the contracting lender and contractually defined "related third parties."
  - As the defendant was not the lender and did not fall within the court's construction of who qualified as a "related third party," the defendant was unable to assert the class action waiver.
- The court extended the prospective waiver doctrine beyond the arbitration provision context and found that the class action waiver did not permit borrowers to effectively vindicate their federal rights, as the waiver was governed solely by Tribal law.

Southern District of California Grants a Non-Tribal Defendant's Motion to Compel Arbitration

In *Huntley v. Rosebud Economic Development Corporation*, the Southern District of California granted a motion to compel arbitration of a borrower's claims against a non-Tribal entity that worked with a Tribal arm, but whom plaintiff alleged controlled the lending operation. In granting the motion, the court:

- Held that the defendant — a non-signatory to the loan agreement — could invoke the arbitration provision under:
  - Under equitable estoppel grounds because the plaintiff's claims were intertwined with the underlying contract, and the plaintiff alleged the defendant's conduct was substantially interdependent on the contract's signatory's conduct.
  - As an intended beneficiary, because the contract extends arbitration rights to "affiliated entities," and the complaint described the lender and defendants as interconnected.

[1] The Breakthrough factors include (1) the method of the entities' creation; (2) their purpose; (3) their structure, ownership, and management; (4) the Tribe's intent to share its sovereign immunity; (5) the financial relationship between the Tribe and the entities; and (6) the policies underlying Tribal sovereign immunity and the entities' connection to Tribal economic development, and whether those policies are served by granting immunity to the economic entities.

The court previously held that "the Tribe had no substantial relationship to the transactions," thereby making the loans subject to various state laws.

- Declined to find that the arbitration provision was unenforceable, as:
  - The Tribe has a body of general contract law which could be relied upon in allowing the arbitrator to make threshold determinations of arbitrability.
  - Contracts of adhesion are not *per se* procedurally unconscionable, and the plaintiffs could have obtained loans elsewhere — cutting against a finding of unconscionability.
  - The lending agreements were not substantively unconscionable, as California has "no strong public policy against a particular rate of interest so long as the charging of that rate is permitted by law to the specific lender," and the lender has a substantial relationship to the Tribe and its governing law.

Damages — After Appeal to the Ninth Circuit, the Central District of California Awarded the CFPB Elevated Penalties Against a Lending Entity and Its CEO

In *Consumer Financial Protection Bureau v. CashCall, Inc.*, the Central District of California ordered $33,276,264 in civil penalties and restitution of $134,058,600 against a Tribal lending entity and its CEO for engaging in a lending scheme deemed an "unfair, deceptive, or abusive act or practice" because the entity collected payments on loans that "were invalid under state law." (*NOTE: CashCall Inc. is not affiliated with CashCall Mortgage, a division of Impac Mortgage Corp.*) The court previously held that "the Tribe had no substantial relationship to the transactions," thereby making the loans subject to various state laws. In ordering this relief, the court stated:

- A tier-one penalty was appropriate for violations of the CFPA for nearly two years — as a "first-tier penalty requires no showing of scienter" by the defendant — and accordingly, ordered a penalty of $5,000 for each of the 773 days.
- A tier-two penalty was appropriate for nearly three years for violations of the CFPA starting in September 2013 — resulting in penalties of $25,000 per day — as the danger that the "conduct violated the statute was so obvious that CashCall must have been aware of it" because:
  - CashCall's counsel recommended stopping the program due to the regulatory and litigation environment, but CashCall continued to collect on loans and modified loans in states in which it had reached settlements with regulators.
  - The court also considered CashCall's prior terminated rent-a-bank model that closed due to enforcement actions by two states and regulatory pressure from the Federal Deposit Insurance Corporation.

With respect to restitution, the Ninth Circuit held scienter is not required for ordering restitution and whether consumers received any benefit is irrelevant. Accordingly, the court ordered restitution to compensate consumers for their losses. ■

UNIFORM COMMERCIAL CODE AND BANKING

Contributors: Jon Hubbard, Mary Zinsner, Elizabeth Briones, Sarah Siu, Stephen Steinlight

Looking Back at 2023

Banking institutions continue to see an increasing regulatory environment in 2023, as well as a steady increase in fraud related litigation. While courts continue to require privity for many wire transfer and fraud cases, there has been an increase of wire transfer cases implicating UCC defenses and Ponzi-scheme related litigation. The year was a busy one for bank litigation and regulatory attorneys.

Notable Regulatory Activity in 2023

On February 28, 2023, the Financial Crimes Enforcement Network of the U.S. Department of Treasury (FinCEN) issued an alert warning financial institutions to be vigilant in identifying and reporting check fraud schemes targeting the U.S. Mail. This type of fraud generally pertains to the negotiation of checks stolen from the U.S. Mail. According to FinCEN, fraud, including check fraud, is the largest source of illicit proceeds in the United States. 2021, FinCEN saw a 23% increase in the number of check fraud-related Suspicious Activity Reports (SARs). This upward trend continued in 2022, when the number of SARs related to check fraud nearly doubled. In conjunction with the U.S. Postal Inspection Service, FinCEN has identified red flags to help financial institutions identify and report such suspicious activity. These include:

- Non-characteristic large check amounts to a new payee.
- Customer complains that a check they mailed was never received.
- Checks used to withdraw funds from a customer's account appear to be of a noticeably different check stock than that used by the issuing bank.
- Existing customer with no history of check deposits has new deposits and withdrawals or transfer of funds.
- Checks show faded handwriting underneath darker handwriting, giving the appearance that the original handwriting has been overwritten.
- New customer opens an account seemingly used only for the deposit of checks followed by withdrawals and transfer of funds.

On May 10, 2023, the Consumer Financial Protection Bureau (CFPB) noted in its Consumer Financial Protection Circular 2023-02 that a financial institution reopening a closed deposit account to process a transaction constitutes an unfair act or practice under the Consumer Financial Protection Act (CFPA). The CFPB also noted that, depending on the circumstances, reopening a closed deposit account may implicate the CFPA's prohibition on deceptive or abusive acts or practices. This guidance appears to be an extension of the CFPB's continuing war on "junk fees." It is also notable because, as noted in Consumer Financial Protection Circular 2022-01, the CFPB's circulars are chiefly designed to provide guidance to other regulators about how to interpret and apply consumer financial laws for which the CFPB has primary jurisdiction. As a result, this guidance will impact not only CFPB-supervised financial institutions, but also those institutions supervised by other federal and state regulators.

On April 26, 2023, both the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) issued separate advisories warning against the risks associated with overdraft fees; particularly those associated with "Authorize Positive, Settle Negative" (APSN) transactions. APSN transactions occur when a customer's account has a sufficient available balance to cover a debit card transaction when the transaction is authorized, but due to one or more intervening transactions, has an insufficient balance to cover the transaction at the time it settles. The agencies warn that failure to take steps to avoid assessing overdraft-related fees in APSN transactions result in heightened risks of violations of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which prohibits any covered person or service provider from engaging in any unfair, deceptive, or abusive acts or practices in connection with a consumer financial product or service, and Section 5 of the Federal

Trade Commission (FTC) Act, which prohibits unfair or deceptive acts or practices. APSN fees have received scrutiny from the Consumer Financial Protection Bureau (CFPB). For example, the CFPB's [2015 Supervisory Highlights] and a [June 2022 Circular] both discuss this as a prohibited practice. The CFPB has also brought enforcement actions against financial institutions that engage in charging APSN fees.

Fraud Litigation

We Continue to See an Increase in Litigation Arising from Wire Transfers and Business Email Compromise Schemes.

In *Kent Group Partners LLC v. Citizens Bank, N.A.*, — F. Supp. 3d —, 2023 WL 5352051 (N.D. Ohio Aug. 21, 2023), the US District Court for the Northern District of Ohio continued to apply general principles of the UCC, including the requirement that a bank must have actual knowledge of a mismatch between the beneficiary account name and account number in order to be liable for an Article 4A violation. In this case, the sender of the wire transfer filed a suit against the beneficiary bank alleging violations of the UCC and the Bank Secrecy Act, as well a claim for common law conspiracy after the sender of the wire was scammed by a business email compromise scheme. The court, relying on the fact that the UCC defines knowledge as actual knowledge, found that the party claiming that the bank actually knew about the name discrepancy must plead particular facts supporting the claim of actual knowledge. As to the Bank Secrecy Act claim, the court ruled that banks have no generalized duty to seek out thieves and terrorists; banks are not, by way of statute, guarantors of the integrity of the deals of their customers. The civil conspiracy claim failed under law.

Courts Continue to Find that Common Law Claims Arising from Wire Transfers are Preempted by the UCC.

In *Niram, Inc. v. Sterling National Bank*, — F. Supp. 3d, —, 2023 WL 6394007v (S.D.N.Y. Sept. 29, 2023, the U.S. District Court of Southern District of New York found that the UCC preempted the common law claims for gross negligence and breach of contract. The wire transfers were initiated by the bank's customer's employee after the employee received instructions from fraudsters. The court found that the employee had authority to initiate the wire transfers on behalf of the employer under New York's agency principles. The UCC preempted the common law claims because Article 4A provided exclusive remedy for customer's claimed injury of loss of money from the transfers.

Courts Recognize a UCC Privity Requirement in Wire Fraud Cases

Courts continued to require parties seeking to recover under the UCC to have privity with the party they are suing. For example, in I*mperium Logistics LLC v. Truist Financial Corporation*, — F. Supp. 3d —, 2023 WL 5154497 (E.D. Mich. Aug. 10, 2023), plaintiffs were supposed to receive a series of wire transfers, but the sender of the wire transfers fell victim to a scam and sent the wire transfers to fraudsters. Plaintiffs sued the beneficiary bank seeking to recover under the UCC. The U.S. District Court of the Eastern District of Michigan described the plaintiffs as third-party beneficiaries who "have no role to play here." Even if the plaintiffs suffered an injury from a wire transfer, the plaintiffs lacked privity to assert any remedy against Truist under the UCC. Plaintiffs were not the sender of the wire transfer and therefore they could not recover under the UCC.

Privity requirements continue to be a significant topic. The Clearinghouse Association LLC and NACHA filed an amicus brief in support of Appellant 1st Advantage Credit Union in *Studco Building Systems US, LLC v. 1st Advantage Credit Union*, arguing that the lower court erred by holding the beneficiary bank liable for fraud perpetrated by another party on the originator. The lower court's ruling flouts Article 4A liability regime under which the beneficiary's bank liability run only to those who it is in privity through the receipt of the payment order. Article 4A displaces common law obligations like bailment in favor of a unitary frameworks.

2023 Saw a Rise in Bank Liability for Allegations Related to Ponzi Schemes by Third Parties.

In April, a jury entered a $95 million verdict against an international financial institution. Plaintiffs, liquidators representing companies set up to issue notes to investors in real estate, alleged that the bank disregarded warning signs about a real estate Ponzi scheme involving hundreds of millions of dollars. Specifically, they alleged that the bank knew that the plaintiff investors' funds weren't being used for their intended purpose but nonetheless wrongly allowed fraudsters use a shell company as part of the Ponzi scheme to open accounts and improperly transfer investors' funds. The investors brought claims of negligence, fraudulent trading, breach of fiduciary duty, and aiding and abetting. The jury found the bank liable for negligence, though not for the other counts, awarding $95 million in damages and $38 million in prejudgment interest.

The defendant sought a new trial, arguing that the court erred by declining to instruct jurors to apportion damages on the basis of comparative negligence. In September, the court rejected the bank's arguments for a new trial, stating that the case stemmed from an intentional tort, albeit by nonparties, so the requested "comparative negligence" instruction was not proper. The court further ruled that the exculpatory clause in the parties' agreements did not bar a jury from finding that the bank had a duty of care, and that it had properly provided a limiting instruction to the jury regarding proximate causation. The court reduced the amount of prejudgment interest to just over $16,000 (for the day between the verdict and entry of final judgment) but left the $95 million award intact.

Similar allegations, claiming that banks failed to satisfy their duty of care in connection with Ponzi schemes, continue to surface in bankruptcy suits brought by trustees, as well as in other contexts.

Negotiable Instruments

In *Quality Leasing Co., Inc. v. Forde Trucking Inc.*, — F. Supp. 3d —, 2023 WL 2538675 (S.D. Ind. March 16, 2023), the payor bank was liable for conversion under the UCC. The check was made payable to payees. One payee received the check, deposited it, and failed to split the funds with the other payee. The other payee then sued the payor bank for statutory conversion under the UCC. The payor bank argued that a payee who did not receive delivery of the check is precluded from bringing a conversion claim. The court rejected this argument because the check was delivered to at least one payee, and under the UCC, delivery of an instrument to one payee constitutes delivery to all payees.

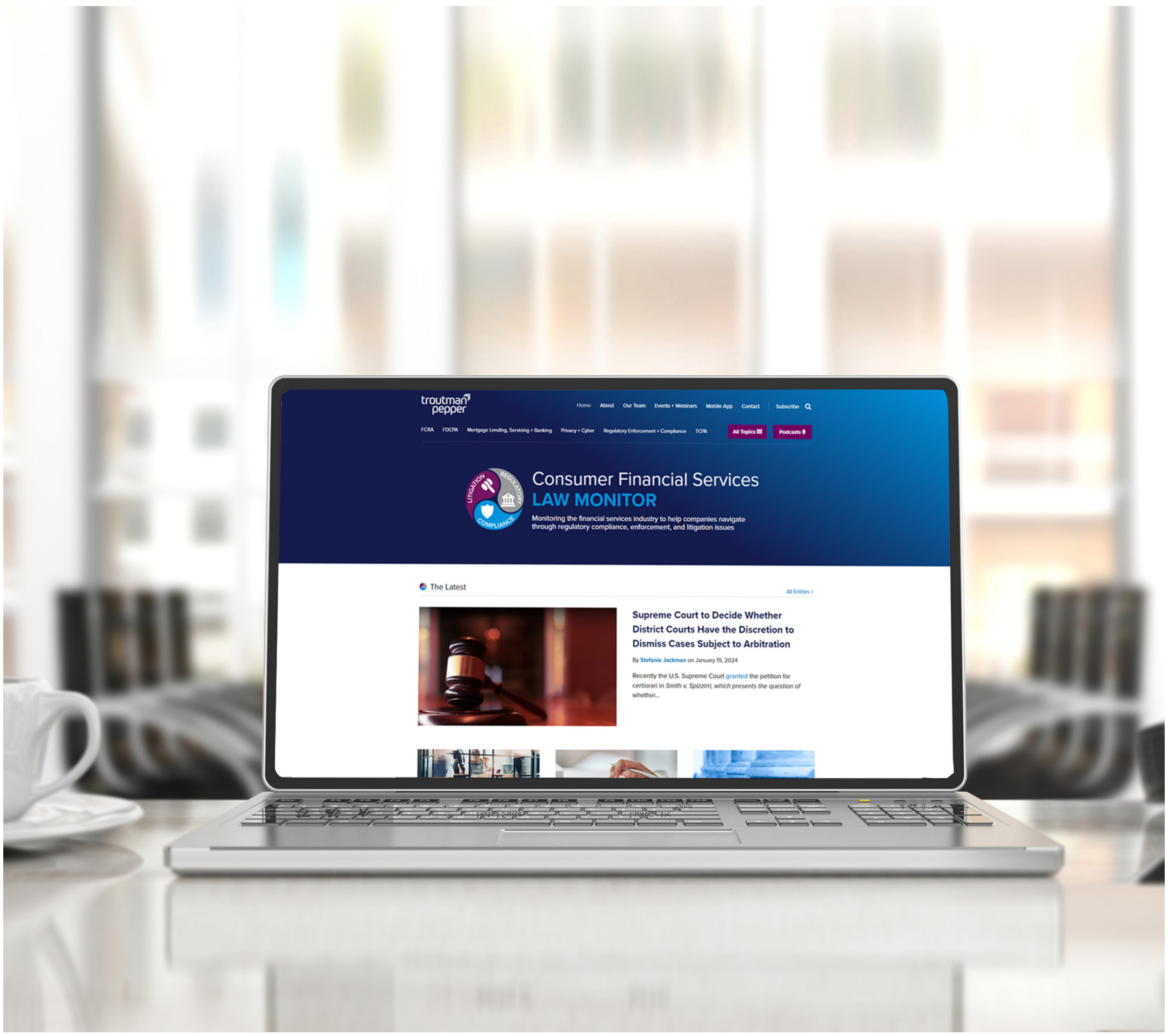
Looking Forward to 2024

This year, we expect fraud and wire transfer litigation to continue to proliferate, especially cases involving third-party scams against the elderly. Bank litigators should continue to rely on lack of privity and other defenses available under the UCC, and in elder fraud cases, various state and federal safe harbor provisions for reporting elder fraud. We also anticipate that the CFPB will continue with robust enforcement activity in the deposit banking arena and other transactions implicating individual consumers. Troutman Pepper attorneys are here to help financial institutions with these issues. ■

CONSUMER FINANCIAL SERVICES LAW MONITOR

The Consumer Financial Services Law Monitor blog offers timely updates regarding the financial services industry to inform you of recent changes in the law, upcoming regulatory deadlines, and significant judicial opinions that may impact your business. We report on several sectors within the consumer financial services industry, including payment processing and prepaid cards, debt buying and debt collection, credit reporting and data brokers, background screening, cybersecurity, online lending, mortgage lending and servicing, auto finance, and state AG, CFPB, and FTC developments.

We aim to be your go-to source for news in the consumer financial services industry. Please email cfslawmonitor@troutman.com to join our mailing list to receive periodic updates, or visit the blog at www.consumerfinancialserviceslawmonitor.com.



CONSUMER FINANCIAL SERVICES WEBINAR OPPORTUNITIES

Troutman Pepper's Consumer Financial Services Practice Group produces webinars throughout the year (many offering CLE credit) related to a variety of consumer financial services topics, including:

- Case Law Updates
- Class Action Litigation
- Consumer Financial Protection Bureau (CFPB) Enforcement and Regulatory Guidance
- Background Screening
- Bankruptcy
- Electronic Funds Transfer Act (EFTA)
- Fair Credit Reporting Act (FCRA)
- Fair Debt Collection Practices Act (FDCPA)
- Fair Housing Act (FHA)
- Federal Trade Commission (FTC) Enforcement and Regulatory Guidance
- Fintech
- Mortgage Litigation and Servicing
- State Attorneys General Investigations
- Telephone Consumer Protection Act (TCPA)

Our goal is to deliver the most useful webinar content possible. These webinars are designed to help you navigate the most complex litigation, regulatory enforcement, and compliance challenges. We welcome topic suggestions. Please send them to us at cfslawmonitor@troutman.com.

To be notified of new webinars, please sign up at https://www.consumerfinancialserviceslawmonitor.com/subscribe/.

CONSUMER FINANCIAL SERVICES PODCASTS

Troutman Pepper's *The Consumer Finance Podcast* provides reliable, insightful, and entertaining industry-specific content central to consumer financial services.

Supplementing our current webinar, advisory, and blog thought leadership, this weekly podcast features industry experts, insiders, and other Troutman Pepper attorneys delivering easily digestible analyses on a variety of thought-provoking topics, covering:

- Debt Collection
- Fintech
- Student Lending
- Auto Finance
- Privacy and Cybersecurity
- Litigation Trends
- Fair Lending
- Federal and State Regulation and Enforcement

FCRA Focus is dedicated to discussing all things related to the Fair Credit Reporting Act, which regulates the collection of consumers' credit information and access to their credit reports.

Each episode explores an interesting aspect of credit reporting, with the aim of providing new insights that help consumer finance businesses do their jobs better. Guests from the industry and lawyers for consumers as well as business insiders join us monthly in this podcast series.

Both podcasts are available on the Troutman Pepper website; our blog, *The Consumer Financial Services Law Monitor*; Google Podcasts; Spotify; Apple Podcasts; and various other podcast platforms.

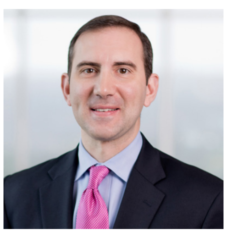
CONSUMER FINANCIAL SERVICES PRACTICE GROUP

David N. Anthony
Partner
Richmond
david.anthony@
troutman.com
804.697.5410

Justin D. Balser
Partner
Virtual
justin.balser@
troutman.com
949.622.2443

Brooke K. Conkle
Partner
Richmond
brooke.conkle@
troutman.com
804.697.1873

Jason M. Cover
Partner
Philadelphia
jason.cover@
troutman.com
215.981.4821



D. Kyle Deak
Partner
Raleigh
kyle.deak@
troutman.com
919.835.4133

Virginia B. Flynn
Partner
Charlotte
virginia.flynn@
troutman.com
804.697.1480

Chad R. Fuller
Partner
San Diego
chad.fuller@
troutman.com
858.509.6056

Mark J. Furletti
Partner
Philadelphia
mark.furletti@
troutman.com
215.981.4831

David M. Gettings
Partner
Virginia Beach
dave.gettings@
troutman.com
757.687.7747

Cindy D. Hanson
Partner
Atlanta
cindy.hanson@
troutman.com
404.885.3830

CONSUMER FINANCIAL SERVICES PRACTICE GROUP

Jon S. Hubbard
Partner
Richmond
jon.hubbard@
troutman.com
804.697.1407

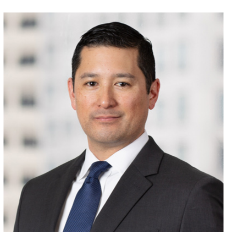
Stefanie H. Jackman
Partner
Atlanta
stefanie.jackman@
troutman.com
404.885.3153

Anthony C. Kaye
Partner
Salt Lake City
tony.kaye@
troutman.com
470.832.5565

Scott Kelly
Partner
Richmond
scott.kelly@
troutman.com
804.697.2202

James Kim
Partner
New York City
james.kim@
troutman.com
212.704.6121

Michael E. Lacy
Partner
Richmond
michael.lacy@
troutman.com
804.697.1326



Kalama M. Lui-Kwan
Partner
San Francisco
kalama.lui-kwan@
troutman.com
415.477.5758

John C. Lynch
Partner
Virginia Beach
john.lynch@
troutman.com
757.687.7765

Drew Mann
Partner
Washington, D.C.
drew.mann@
troutman.com
202.274.2907

Jason E. Manning
Partner
Virginia Beach
jason.manning@
troutman.com
757.687.7564

CONSUMER FINANCIAL SERVICES PRACTICE GROUP

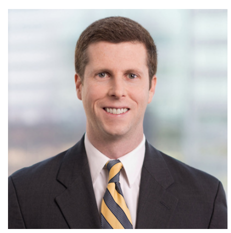
Ethan G. Ostroff
Partner
Washington, D.C.
ethan.ostroff@
troutman.com
757.687.7541

Kim Phan
Partner (Privacy + Cyber Practice Group)
Washington, D.C.
kim.phan@
troutman.com
202.274.2992

Joseph Reilly
Partner
Washington, D.C.
joseph.reilly@
troutman.com
202.274.2908

Jeremy T. Rosenblum
Partner
Philadelphia
jeremy.rosenblum@
troutman.com
215.981.4867

Lori J. Sommerfield
Partner
Washington, D.C.
lori.sommerfield@
troutman.com
202.274.2998



Timothy J. St. George
Partner
Richmond
tim.st.george@
troutman.com
804.697.1254

Jessamyn E. Vedro
Partner
Los Angeles
jessamyn.vedro@
troutman.com
213.928.9845

Christopher J. Willis
Partner
Atlanta
chris.willis@
troutman.com
404.885.3157

Alan D. Wingfield
Partner
Richmond
alan.wingfield@
troutman.com
804.697.1350

Mary C. Zinsner
Partner
Washington, D.C.
mary.zinsner@
troutman.com
202.274.1932

CONSUMER FINANCIAL SERVICES PRACTICE GROUP

Counsel

Elizabeth H. Andrews
San Francisco

Katalina Baumann
Orange County

Megan E. Burns
Virginia Beach

Massie P. Cooper
Richmond

Andrea M. Hicks
Orange County

Jonathan M. Kenney
Virginia Beach

Mark D. Kundmueller
Virginia Beach

Sarah E. Pruett
New York City

Sarah T. Reise
Atlanta

Caleb N. Rosenberg
Washington, D.C.

Jamie Z. Roth
Virtual

James K. Trefil
Richmond

Shari J. Turkish
Virtual

Gilliam Williston
Virginia Beach

Mark J. Windham
Atlanta

Associates

Elizabeth M. Briones
Washington, D.C.

Noland Butler
Richmond

Christopher J. Capurso
Richmond

Stefanie Cerrone
New York City

Jenny C. Chien
San Francisco

Peter S. Cox
Richmond

Kevin R. Craig
Virginia Beach

Joseph M. DeFazio
New York City

Jonathan DeMars
Richmond

Noah J. DiPasquale
Richmond

Erin E. Edwards
Chicago

Nicole ElMurr
Philadelphia

Christine R. Emello
Atlanta

Tina S. Felahi
San Diego

Jonathan P. Floyd
Richmond

Taylor R. Gess
Virtual

Rachel Goldner
New York City

Melanie Griffith
Virtual

Courtney T. Hitchcock
Virginia Beach

Selene Houlis
Los Angeles

Joshua D. Howell
Richmond

Eli Kaplan
Virginia Beach

Kathleen M. Knudsen
Virginia Beach

Jed Komisin
Richmond

Jacob Kozaczuk
San Diego

Ryan Lewis
San Francisco

Stephen D. Lozier
Chicago

Nathan R. Marigoni
Salt Lake City

Josh McBeain
Salt Lake City

Meagan A. Mihalko
Richmond

Addison J. Morgan
Virtual

Carter R. Nichols
Richmond

Susan N. Nikdel
Orange County

Christine Nowland
San Diego

Rachelle Pointdujour
New York City

Gayatri Raghunandan
San Francisco

Jake A. Rodon
Atlanta

Jeremy C. Sairsingh
Philadelphia

Angie Shewan
Salt Lake City

Sarah E. Siu
Richmond

Stephen J. Steinlight
New York City

CONSUMER FINANCIAL SERVICES PRACTICE GROUP

Zachary A. Turk
Washington, D.C.

Jovanni Villa
San Francisco

Attorneys

David M. Asbury
Virginia Beach

Maddie Baruch
Charlotte

Jared D. Bissell
San Diego

Michala D. Black
Virginia Beach

Paul W. Boller
Virginia Beach

Thailer A. Buari
Washington, D.C.

Ralph V. Cole
San Diego

Kelly A. Cournoyer
Virginia Beach

Kristen T. Eastman
Virginia Beach

Dorrella Gallaway
Virtual

Kim R. Gershen
Virginia Beach

Brian J. Hamilton
Virginia Beach

Alec Hayes
Atlanta

Christine Hehir
Los Angeles

Matthew P. Holm
Chicago

James D. Horne
Charlotte

Lauren Howells
Washington, D.C.

Nicholos Jimenez
Virginia Beach

Ahmed H. Khattab
New York City

Sean B. Kirby
Virtual

Punit K. Marwaha
Chicago

Brenna McGill
Los Angeles

Chiemela Okwandu
Los Angeles

Rachel B. Ommerman
Virtual

Kearstin H. Sale
Atlanta

Stephen Skepnek
Virtual

Leah S. Strickland
Virginia Beach

Brittany Taylor
Washington, D.C.

Benjamin White
San Diego

Brody R. Wight
Virtual

Peter Yould
Orange County

Albert A. Zakarian
Virtual

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