Client Alert

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FDIC Action Is a Reminder that Bank Partnerships Are Not a Panacea for Non-Banks

By Oliver I. Ireland, Sean Ruff, and Jeremy R. Mandell

On May 11, 2017, the Federal Deposit Insurance Corporation (FDIC) announced that it had reached settlements with Bank of Lake Mills (Bank) and two of its "institution-affiliated parties" (IAPs)—Freedom Stores, Inc. (FSI) and Military Credit Services, LLC (MCS)—for allegedly engaging in unfair and deceptive practices in violation of Section 5 of the Federal Trade Commission (FTC) Act.

The FDIC released orders for restitution and to pay civil money penalties (Orders), but did not release the consent agreements executed by the Bank, FSI or MCS with the stipulated facts and findings. Nonetheless, the Orders define "Eligible Consumers" to include consumers who have applied for and received loans from the Bank through the FSI or MCS channels. The FDIC, therefore, appears to take the position that FSI and MCS are IAPs as a result of operating a channel for a Bank-originated loan.

The specific unfair and deceptive practices identified by the FDIC in its press release include:

- Charging interest to consumers who paid off their loans within six months when the loans were promoted as six-month interest free;
- Selling add-on products in conjunction with loans originated by the bank without clearly disclosing the terms of those products; and
- Failing to provide consumers the opportunity to exercise the monthly premium payment option in conjunction with the purchase of optional debt cancellation coverage on loans originated by the Bank through partner channels.

The Bank Order requires the Bank to pay approximately $3 million in restitution to Eligible Consumers, and the Orders require the Bank, FSI and MCS to pay civil money penalties of $151,000, $54,000 and $37,000, respectively.

The Orders serve as a caution to non-banks that partnering with banks to offer loan products does not insulate them from enforcement actions. IAPs are subject to the same enforcement regime as banks, including cease and desist orders and civil money penalties. 12 U.S.C. § 1818(b) and (i).

The term IAP includes any "agent for an insured depository institution" and "any independent contractor … who knowingly or recklessly participates in any violation of any law or regulation; any breach of fiduciary duty; or any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution." 12 U.S.C. § 1813(u). Accordingly, in the context of bank partnerships, non-bank partners could be subject to direct enforcement actions if the non-bank partner:

a) Knowingly or recklessly participates in any violation of any law or regulation, breach of fiduciary duty, or unsafe or unsound practice that

b) Caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.

Bank regulators, including the FDIC and the Office of the Comptroller of the Currency, have brought direct action against non-bank contractors that engaged in unsafe practices that resulted in non-minimal losses to banks. *See, e.g.*, *Cavallari v. OCC*, 57 F.3d 137 (2d Cir. 1995) (independent contractor negotiating loan workouts acted recklessly in engaging in an unsafe practice that resulted in non-minimal loss to the bank).

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