Q1 2024

WILSON SONSINI

Focus on Fintech

Welcome to Wilson Sonsini's *Focus on Fintech* newsletter. This quarterly newsletter provides ongoing analysis and commentary on regulatory developments impacting the fintech industry.

In this issue, our attorneys discuss updates and developments from federal regulators, including those related to the intersection of fintech and artificial intelligence, cryptocurrency and virtual currency updates, and consumer protection. We also discuss rule updates from the SEC and FinCEN, and we examine the continued scrutiny by the FDIC, the FTC, and FINRA on fintech marketing. Finally, we wrap up this edition with our state law round-up, which discusses Kansas' and Wisconsin's adoption of a licensing framework for earned wage access providers and New York's new surcharge law.

Bank-Fintech Partnerships

FDIC Announces Consent Orders with Banks Regarding Their Third-Party Partnerships with Fintechs

Since the start of 2024, the Federal Deposit Insurance Corporation (FDIC) has issued multiple consent orders to various banks regarding their fintech partnerships, namely Lineage Bank on January 30, 2024, Sutton Bank on February 1, 2024, and Piermont Bank on February 27, 2024. Generally, the consent orders focused on the banks' third-party risk management programs and compliance with applicable laws (such as anti-money laundering and consumer protection laws). These banks are required to conduct risk assessments, which include reviewing third-party partnerships and addressing the deficiencies identified in their respective consent orders. These consent orders follow the release of the final Interagency Guidance on Third-Party Relationships: Risk Management and are the latest in enforcement actions focused on third-party risk management programs, in particular in connection with fintech partnerships. For more information on third-party risk management, see our alert, "Guardrails for Bank-Fintech Partnerships: The Federal Banking Agencies Finalize Third-Party Risk Management Expectations."

In This Issue

Artificial Intelligence and Fintech

SEC AI Enforcement Actions

The U.S. Securities and Exchange Commission (SEC) announced settled charges against two investment advisers, Delphia (USA) Inc. and Global Predictions Inc., in connection with false and misleading statements regarding their use of artificial intelligence (AI). The SEC alleged, among other things, that each investment adviser made statements in marketing and regulatory filings about its purported use of AI, but neither could back up its statements when examined. The SEC alleged the advisers violated the antifraud provisions of the Investment Advisers Act of 1940. These charges, both announced on the same day, underscore the SEC's scrutiny of the use of AI and statements about AI by investment advisers and other regulated entities, and may be a harbinger of more SEC activity in connection with AI. For additional insights, please see our *Fintech in Brief* post on these actions.

SEC Chair Gary Gensler Reiterates Focus on AI

In his prepared remarks before Yale Law School, SEC Chair Gary Gensler focused on the potential for fraud in connection with the use of AI, including through AI-washing. Chair Gensler also noted the conflicts of interest that may arise when a firm uses AI in its product offerings, referencing the rule proposal that was

released in July 2023 addressing Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers.

Additionally, Chair Gensler highlighted the importance of model risk management, in particular with the interconnectedness of today's financial institutions. Focusing on investor protection, Chair Gensler noted that those who "deploy a model [must] put in place appropriate guardrails."

Treasury Releases Report on Managing AI Risks in the Financial Sector

On March 27, 2024, the U.S. Department of the Treasury (Treasury) released a report on managing AI-specific cybersecurity risks in the financial services sector. The report was written at the direction of Presidential Executive Order 14110 on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence, which we previously summarized. Following in-depth interviews with financial services and technology companies, the report identifies several challenges and opportunities that AI presents to the financial services sector, focusing on the use of AI to detect fraud and how AI is being used to commit fraud. Among the report's top-line conclusions, Treasury recommends that financial institutions expand and strengthen their risk management and cybersecurity practices to account for AI systems' advanced and novel capabilities, consider greater integration of AI solutions into their cybersecurity practices, and enhance collaboration, particularly threat information sharing. The report also acknowledges the importance of data for AI technology and the complexity of AI technology development, which Treasury anticipates would very likely increase financial institutions' reliance on third-party providers of data and technology.

Rulemaking Updates

SEC Adopts Amendments to the Internet Adviser Exemption

The SEC adopted amendments to the "Internet Adviser Exemption" under the Investment Advisers Act of 1940, which allows investment advisers that only provide advice through an interactive website to register federally with the SEC, even if they do not satisfy the assets under management (AUM) threshold for federal registration (normally, advisers with less than $100 million in AUM register at the state rather than the federal level). The amendments eliminate a *de minimis* exception that permitted advisers relying on the Internet Adviser Exemption to have fewer than 15 clients advised through means other than an interactive website. The amendments also require (i) that investment advisers have an "operational interactive website" at all times (the existing Internet Adviser Exemption does not expressly require that the website be operational at all times), and (ii) that the investment adviser provides advice to more than

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Rulemaking Updates *(Continued from page 2)*

one person. Investment advisers relying on the Internet Adviser Exemption must comply with the amended Internet Adviser Exemption by March 31, 2025.

SEC Expands the Definition of "Dealer"

In February 2024, the SEC announced the adoption of two rules expanding the definitions of "dealer" and "government securities dealer" under the Securities Exchange Act of 1934 (Exchange Act) by defining the phrase "as part of a regular business" in those definitions. The expanded definition of "dealer" establishes two non-exclusive ways to determine whether a market participant is engaged in a regular pattern of providing liquidity to other market participants "as part of a regular business" and consequently required to register as a "dealer" under the Exchange Act. Under the final rules, a person buying and selling securities for their own account is engaged in activity "as part of a regular business" if the person (i) regularly expresses trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants, or (ii) earns revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest. These new rules apply to market participants, including digital asset market makers. In the adopting release, the SEC clarified that the technology used, "including distributed ledger technology-based protocols using smart contracts," would not "preclude crypto asset securities activities from falling within the scope of dealer activity." The final rules became effective on April 29, 2024, with a compliance deadline of April 29, 2025.

FinCEN Issues Notice of Proposed Rulemaking to Expand AML/CFT Obligations to Cover Certain Investment Advisers

On February 13, 2024, FinCEN issued a notice of proposed rulemaking (NPRM) that would extend the applicability of the Bank Secrecy Act's affirmative anti-money laundering/countering the financing of terrorism (AML/CFT) obligations to federally registered investment advisers and "exempt reporting advisers" (i.e., advisers to private funds and venture capital funds that notice file rather than register with the SEC). Investment advisers currently do not have AML obligations under the Bank Secrecy Act like other "financial institutions"; the proposed rule would require covered investment advisers to (i) implement and maintain a written AML/CFT program; (ii) file suspicious activity reports and currency transaction reports for transactions above $5,000 and $10,000, respectively; and (iii) maintain certain records, including records of compliance. If adopted as is, covered investment advisers would be required to comply with the final rule within 12 months after the final rule's effective date. Please see our recent alert, "FinCEN Proposed Significant Expansion of AML/CFT Obligations to Cover Registered Investment Advisers, Venture Capital Advisers, and Private Fund Advisers," for more information.

Cryptocurrency and Virtual Currency Updates

CFTC Sues Crypto Site over $2.3 Million "Pig Butchering" Scam

On January 17, 2024, the Commodity Futures Trading Commission (CFTC) filed a complaint against Debiex, an unregistered cryptocurrency exchange, in Arizona federal court alleging that Debiex violated the Commodities Exchange Act (CEA) by conducting "pig butchering" schemes. In such schemes, criminals establish a trust relationship with their victims (referred to as "pigs"), convince them to invest money in fraudulent virtual currency schemes, and take their entire investment, leaving the victims with nothing. The CFTC's complaint also includes Zhāng Chéng Yáng as a relief defendant, alleging that Yáng acted as a money mule for Debiex. In its complaint, the CFTC seeks restitution to defrauded customers, disgorgement of all ill-gotten gains, civil monetary penalties, a trading ban, and a permanent injunction against further violations of the CEA and CFTC regulations. This complaint follows the recent "FinCEN Alert on Prevalent Virtual Currency Investment Scam Commonly Known as 'Pig Butchering.'"

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Cryptocurrency and Virtual Currency Updates *(Continued from page 3)*

Please see our [Q3 2023 *Focus on Fintech*] issue for more information.

Coinbase Ruling

On March 27, 2024, a federal court in the Southern District of New York denied in part a motion to dismiss an SEC enforcement action against defendants Coinbase, Inc. and Coinbase Global, Inc. (collectively, Coinbase). The court held that the SEC plausibly asserted that at least some crypto asset transactions on Coinbase's platform involved investment contracts and thus securities—and, as a result, that the SEC plausibly asserted that Coinbase acted as an unregistered broker, an unregistered exchange, and an unregistered clearing agency with respect to those securities transactions. In contrast, the court dismissed claims that Coinbase's Wallet service may have functioned as an unregistered broker because the SEC's allegations did not implicate many of the factors used to identify a "broker." In making this determination, the court noted that while the Wallet does help users discover pricing, providing pricing comparisons does not rise to the level of making investment recommendations. The court also noted that the fact that Coinbase had at times received a commission did not on its own cause Coinbase to be a "broker." Further, the court held that the "Major Questions Doctrine" was not implicated by the SEC's enforcement action against Coinbase because the crypto industry, while sizable, "falls far short of being a portion of the American economy bearing vast economic and political significance."

CFPB Issues Report on Risks to Consumers in Video Games and Virtual Worlds

On April 4, 2024, the Consumer Financial Protection Bureau (CFPB) issued its report on "Banking in video games and virtual worlds," detailing trends and risks in the online gaming industry. In its report, the CFPB examines the ability of a game's players to purchase in-game currencies with U.S. dollars and use these in-game currencies to purchase virtual goods and services within the game, resembling financial activity. As reflected in the statement of CFPB Director Chopra accompanying the report, the areas of regulatory scrutiny include consumer harm arising from scams, fraud, theft, and unanticipated purchases and the lack of recourse for players. The report also highlights the potentially large amounts of data collected by gaming platforms about their players, which could be monetized and used to encourage further spending.

Operators of gaming platforms and virtual worlds can expect increased regulatory scrutiny of in-game transactions and gaming currencies. Following the report, operators of such platforms should consider, among other things, whether their policies and procedures are sufficiently robust with respect to handling customer complaints and terminating accounts, whether the costs of gaming assets are clear to players, whether there are sufficient anti-money laundering and fraud prevention measures, and whether there are third-party systems designed to facilitate the cash-out process.

Consumer Protection Updates

CFPB Proposes Rule to Close Bank Overdraft "Loophole"

In January 2024, the CFPB proposed a new rule aimed at eliminating a loophole under Regulations E and Z that exempts many overdraft services from key consumer protections. The rule proposal was announced along with a report on "Overdraft and NSF Practices at Very Large Financial Institutions." The proposed rule would require large financial institutions with more than $10 billion in assets to limit their fees for overdraft loans to "breakeven levels" or a CFPB-approved benchmark fee in order to continue using the regulatory exemptions. The CFPB has proposed benchmark fees between $3 and $14 and has requested comments on the appropriate amount. While banks would still maintain the ability to charge above breakeven pricing for consumer overdraft programs, under the proposed rule, such overdrafts would be treated as a line of credit subject to Regulation Z, including the consumer credit disclosure requirements.

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Consumer Protection Updates *(Continued from page 4)*

CFPB Reduces Permissible Penalty Fee Threshold and Banking Associations Challenge Final Amendments

On March 5, 2024, the CFPB finalized amendments to the safe harbor provision in Regulation Z, the federal rule governing credit card penalty fees, including late fees, over-the-limit fees, and return payment fees, for "Larger Card Issuers." "Larger Card Issuers" are card issuers that, together with their affiliates, have one million or more open credit card accounts. Under Regulation Z, a card issuer may not impose a penalty fee unless the card issuer has determined that the dollar amount of the fee represents a reasonable proportion of the total costs incurred by the card issuer or it complies with the safe harbor provisions. The final amendments reduce the late-fee threshold under the safe harbor from $30 or $41 to $8 and remove the inflation adjustments that were previously allowed.

The CFPB has defended the amendments, arguing that the $8 late-fee threshold more accurately estimates Larger Card Issuers' costs arising from late payments, and that higher thresholds could interfere with customers' ability to make future payments.

The final amendments were scheduled to take effect on May 15, 2024, but on May 10, 2024, the U.S. District Court for the Northern District of Texas issued a preliminary injunction pausing the new rule, based on the Fifth Circuit's position that the CFPB is unconstitutionally funded. On May 16, 2024, the U.S. Supreme Court held that the CFPB's funding mechanism is constitutional.

CFPB Warns Remittance Transfer Providers That False Advertising Can Violate Federal Law

The Consumer Financial Protection Act authorizes the CFPB to "take any action … to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service." Remittance transfers are regulated pursuant to the CFPB's Remittance Rule in Regulation E.

The CFPB issued Consumer Financial Protection Circular 2024-02, which includes a few examples of when remittance transfer providers violate the CFPA in marketing remittance transfers, particularly related to material representations or omissions that mislead or that are likely to mislead consumers:

1. "It is deceptive to market remittance transfers as being delivered within a certain time frame, when transfers actually take longer to be made available to recipients."
2. "It is deceptive to market transfers as 'no fee' when in fact the remittance transfer provider charges consumers fees to send the remittance transfer."
3. "It may be deceptive to market promotional fees or promotional exchange rates for remittance transfers without sufficiently clarifying when the offer is only limited or temporary."
4. "It is deceptive to market remittance transfers as 'free' if they are not in fact free."

More generally, the CFPB requires remittance transfer providers to clearly and conspicuously disclose material terms in advertising.

Fintech Marketing

FDIC Issues Five Cease-and-Desist Letters for Misleading Representations About Deposit Insurance

As part of its continued focus on false and misleading representations regarding deposit insurance, the FDIC issued five cease-and-desist letters on January 19, 2024, to non-bank fintech companies. The FDIC focused on a variety of statements by the companies, including statements made on various social media platforms and in marketing videos. In the letters, the FDIC focused on statements by the companies suggesting certain products are FDIC-insured that are not covered by FDIC insurance, misusing the FDIC name or logo, failing to identify which insured depository institutions the companies have a relationship with for the placement of customer deposits, and misrepresenting aspects of deposit insurance. This is only the most recent set of cease-and-desist letters to non-bank fintech companies regarding their advertising related to FDIC insurance and part of the FDIC's continued focus on marketing related to FDIC insurance. For more information about fintech marketing, see our alert, "Fintech Marketing: Navigating the Complex Waters of Federal Regulation."

FINRA Fines Firm over Social Media Influencers' Posts

Following the Financial Industry Regulatory Authority's (FINRA's) targeted exam of firm practices related to social media usage, FINRA settled a social media influencer-related enforcement disciplinary action on March 18, 2024. FINRA alleged that M1 Finance LLC, a FINRA-member firm, paid social media influencers to post content promoting M1 Finance without M1 Finance reviewing or approving the content posted by the influencers and without retaining those communications, as required by FINRA rules. FINRA alleged the content that was posted contained exaggerated, unwarranted, promissory, or misleading claims. As part of the settlement, M1 Finance agreed to pay an $850,000 fine and implement a supervisory program and procedure to ensure compliance with FINRA Rule 2210. FINRA "will continue to consider whether firms are using practices and maintaining supervisory systems that are reasonably designed to address the risks related to social media influencer programs."

FTC Continues to Scrutinize Fintech Marketing Efforts

This year, the Federal Trade Commission (FTC) has continued to crack down on deceptive marketing campaigns in the fintech space, bringing three actions against companies that made allegedly false or misleading claims about their online loan programs. As we previously discussed in this client alert, these actions are part of a broader regulatory focus on how fintech companies market their products and services.

FloatMe

In January 2024, the FTC issued a complaint against FloatMe, alleging that the company promised quick and free cash advantages if consumers subscribed to the service. However, FloatMe did not actually provide consumers with the advertised amounts. Additionally, FloatMe represented to customers that an algorithm sets consumer loan limits and customer service representatives cannot increase the limits. The FTC charges that, in reality, no such algorithm exists and limits were only increased manually by the company's support team. Under the settlement, FloatMe—as well as its co-founders—is required to provide $3 million to be used to refund customers, stop the company's deceptive marketing, make it easier for consumers to cancel their subscriptions, and institute a fair lending program.

Biz2Credit and Womply

In March 2024, the FTC announced actions against Biz2Credit and Womply, claiming that the companies falsely advertised their Paycheck Protection Program (PPP) loan services. The FTC alleged that Biz2Credit misrepresented the speed for application processing and unfairly blocked consumers from applying to other lenders. Similarly, the FTC alleged that Womply falsely represented that it would process PPP loan applications quickly and made misleading and unsubstantiated claims that the company would obtain PPP loans for eligible consumers.

In their respective proposed settlements, Biz2Credit agreed to pay $33 million and Womply agreed to pay $26 million. These monetary awards are the largest damages the FTC has secured under Section 19 of the FTC Act to date.

State Update

Kansas and Wisconsin Adopt Licensing Framework for Earned Wage Access Providers

Earned wage access (EWA) products enable consumers to access their wages before their scheduled payday, with the funds reclaimed either from the consumer's bank account later or directly from the consumer's subsequent paycheck through their employer. Kansas Governor Laura Kelly recently signed into law House Bill 2560, and Wisconsin Governor Tony Evers recently signed into law Wisconsin Act 131, both of which create a regulatory framework for EWA providers. Kansas and Wisconsin follow Missouri and Nevada in enacting EWA legislation. These new laws require EWA providers, regardless of physical location, to register with/obtain licensure from the respective state regulator to provide EWA services to any resident of the respective state. They also require providers to, among other things, (i) implement and maintain policies and procedures to address consumer questions and complaints; (ii) allow the consumer to cancel the EWA service at any time, without incurring a cancellation fee or other penalty; and (iii) clearly and conspicuously disclose all fees associated with the EWA services and the consumer's rights under the EWA agreement. Wisconsin's new law is effective September 1, 2024. Kansas' new law is effective upon publication.

New York's New Surcharge Law Now in Effect

New York's new surcharge law went into effect on February 11, 2024. This new law, which amended New York's existing credit card surcharge law, requires sellers that impose a surcharge on credit card payments to "clearly and conspicuously" post the total price for using a credit card, inclusive of the surcharge. Additionally, the surcharge is limited to the amount that the credit card companies charge the business for accepting credit cards. Sellers may utilize a "two-tier pricing system" to show the credit card price (including the surcharge) alongside the cash price. The penalty for violating New York's surcharge law is $500 for each violation. For additional information, please see New York's guidance on disclosing credit card surcharges.

Select Publications

Fintech in Brief
Focus on Big Tech and Data-Intensive Financial Services: Regulators Signal Shifting Priorities
April 2, 2024

Wilson Sonsini Alert
Revenue Purchase or Predatory Loan? New York Attorney General Targets Merchant Cash Advance Providers
March 25, 2024

Payments Playbook Series
The Embedded Payments Playbook
February 27, 2024

Wilson Sonsini Alert
FinCEN Proposes Significant Expansion of AML/CFT Obligations to Cover Registered Investment Advisers, Venture Capital Advisers, and Private Fund Advisers
February 26, 2024

Fintech in Brief
SEC Action Highlights Questions Related to the Use of Influencers and Index Providers by Investment Advisers
February 21, 2024

Wilson Sonsini Alert
Fintech Marketing: Navigating the Complex Waters of Federal Regulation
January 30, 2024

Fintech in Brief
Trends to Watch in 2024
January 16, 2024

Recent Fintech Practice Highlights

Wilson Sonsini Partner Jess Cheng to Speak at Smarter Faster Payments Conference

Fintech and financial services partner Jess Cheng, along with Derek Schwede (Head of Legal, Modern Treasury) and Evis Daum (Chief Counsel and Chief Risk Officer, Federal Reserve Financial Services), spoke on a panel titled "AI- and Data-Driven Payments: Demystifying the Legal Complexities" at the Smarter Faster Payments Conference on May 8. The panel focused on how AI is impacting the payments landscape and key legal considerations at this fast-changing intersection of technology and regulation.

Wilson Sonsini College for Clients Series: Overview of FinCEN's Beneficial Ownership Information Reporting Requirements and What You Need to Know

Wilson Sonsini recently hosted a webinar on FinCEN's new beneficial ownership information (BOI) regulations under the Corporate Transparency Act (CTA). Presenters included fintech and financial services associate Troy Jenkins.

Wilson Sonsini Partner Jess Cheng Moderates Trends in Finance Panel at Fintech Conference

Fintech and financial services partner Jess Cheng recently moderated a panel discussing FedNow and fintech with panelists Ani Narayan (Modern Treasury), Mollie Markham (Federal Reserve Bank of Chicago), and Tamara Romanek (Plaid).

Wilson Sonsini Partner Jess Cheng Hosts Discussion with Assistant U.S. Attorney Thane Rehn on the Trial of Sam Bankman-Fried

Fintech and financial services partner Jess Cheng recently hosted a discussion with Assistant U.S. Attorney Thane Rehn on the trial of Sam Bankman-Fried following the spectacular fall of crypto exchange FTX. During the discussion, which was covered by *Reuters*, Thane shared reflections on and lessons learned from crypto's trial of the century.

Wilson Sonsini Joins KPMG at Fintech Share Forum

Fintech and financial services partners Amy Caiazza and Jess Cheng joined KPMG at their Fintech Share Forum on March 22, 2024, for a panel discussion focusing on hot topics, regulatory challenges, and compliance issues impacting fintech companies.

Wilson Sonsini Hosts Webinar on Fintech Marketing

In a recent webinar, Wilson Sonsini partners Amy Caiazza, Jess Cheng, and Libby Weingarten discussed how fintech companies can craft innovative marketing campaigns while navigating the complex web of federal regulations. They explored the key regulatory frameworks that fintech companies must comply with when marketing their products and services and considered best practices and common pitfalls.

Wilson Sonsini Partner Jess Cheng Co-authors New Edition of Leading Payments Law Primer

Fintech and financial services partner Jess Cheng recently co-authored with Thomas C. Baxter, Jr. (former General Counsel and Executive Vice President of the Federal Reserve Bank of New York), Stephanie A. Heller (Executive Vice President and General Counsel of The Clearing House), Greg Cavanagh (Senior Vice President, Assistant General Counsel, and Corporate Secretary at The Clearing House), and Laura J. Forman (Assistant General Counsel of the Federal Reserve Bank of New York) the fourth, updated edition of the leading payments law primer, *The ABCs of the UCC Article 4A: Funds Transfers*. This book comprehensively explains the terminology, structure, and workings of Article 4A, which governs funds transfers over wholesale payment systems and certain instant payments.

Wilson Sonsini Partner Jess Cheng Discusses Supervisory Scrutiny of Bank-Fintech Partnerships with *The Fintech Times*

Fintech and financial services partner Jess Cheng was quoted in *The Fintech Times* article "Industry Reacts as OCC Reveals Concerns About Impact of Fintech-Bank Partnerships" discussing the intense supervisory scrutiny around bank-fintech partnerships, stepped-up enforcement actions, and practical considerations for fintech companies as the industry prepares for change.

The following attorneys have editorial oversight of Wilson Sonsini's *Focus on Fintech*.
They would like to take this opportunity to thank Drew Minick, Varun Lella,
Rebecca Weitzel Garcia, and Boniface Echols, who contributed to this edition.

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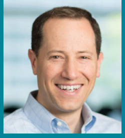

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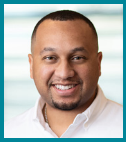

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