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Expert Analysis

Dodd-Frank's New Deputies of Federal Consumer Financial Laws—States

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In the wake of the Financial Crisis, the federal government has invigorated its civil fraud enforcement. The U.S. Department of Justice has dominated the headlines in this area with a series of significant lawsuits and resolutions involving mortgage lenders. Yet, behind the headlines, a curious, new category of enforcers is emerging to target violations of federal civil consumer financial protection laws: state agencies and attorneys general. Passed in July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act quietly deputized state actors to pursue violations of federal consumer financial protection laws, including a broad prohibition against unfair, deceptive or abusive practices. Dodd-Frank empowers state enforcers—both attorneys general and state agencies and regulators—to investigate and enforce its provisions through civil lawsuits alleging, among other things, unfair practices and violations of federal consumer finance regulations issued by the Consumer Financial Protection Bureau (CFPB).

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Not surprisingly, state enforcers have begun using that new power. Last year, New Mexico became the first state to enforce a federal CFPB regulation. This year already has seen no less than four state enforcement actions utilizing Dodd-Frank brought in New York, Illinois and Mississippi. Significantly, these suits have been filed by regulators, such as New York's Department of Financial Services (NYDFS), that otherwise have limited or no power under state law to sue for such deceptive, unfair or abusive practices. These actions represent a new paradigm for the civil enforcement of federal consumer financial protection laws.

Recruiting State Enforcers

Section 1042 of the Dodd-Frank Act empowers state attorneys general and enforcement agencies to investigate and sue consumer finance companies for a broad range of federal consumer financial protection violations. Arguably the most significant of these is Dodd-Frank's prohibition against unfair, deceptive or abusive acts or practices—the so-called UDAAP provisions. 12 U.S.C. §5536. The UDAAP provisions define an act or practice as unfair if it "is likely to cause substantial injury to consumers" and define an act as abusive if it interferes with, or takes advantage of, "a consumer's ability to understand a consumer financial product or service." §5531(c-d). Dodd-Frank also authorizes state regulators to enforce regulations promulgated by the CFPB, including regulations associated with truth-in-lending laws. §5552(a).

Dodd-Frank provides stiff remedies upon a finding of civil liability. It permits any remedy—including injunctive relief, rescission, restitution, disgorgement or unjust enrichment, and damages—except exemplary or punitive damages. Upon a court finding of a violation of federal consumer financial law, moreover, Dodd-Frank imposes civil penalties in the amount of $5,000 per day per each offense, and permits a court to increase the penalty up to $25,000 if the violation was reckless or up to $1 million per day if the violation was intentional. §§5565(a-c). It also permits states to recover the cost of bringing an enforcement action.

Dodd-Frank's provisions extend beyond most pre-existing comparable state laws in a number of significant respects. First, the act's UDAAP provision imposes no scienter requirement for a finding of liability and permits suits for unfair, deceptive or abusive practices. By contrast, many state laws do require a showing of an intent to deceive[1] or (as in New York) do not permit suits for abusive practices. N.Y. Gen. Bus. Laws §349. Expanding the use of the UDAAP provision's new "abusiveness" prong to the states, which otherwise can only sue for unfair or deceptive practices, gives states a potentially powerful device to combat alleged consumer harm.

Second, most state consumer finance laws contain remedial provisions that are a shadow of Dodd-Frank's broad remedies, such as its stiff civil penalties. Section 408 of New York Financial Services Law, for example, has far smaller caps on its civil penalties, allowing civil penalties of up to only $5,000 per offense in connection with an intentionally fraudulent financial product. Section 505/7 of Illinois' Consumer Fraud and Deceptive Trade Practices Act, moreover, limits civil penalties to a per-offense maximum of $50,000. Illinois further limits state actions to only injunctive and restitutionary remedies.

Third, Dodd-Frank authorizes state regulators to sue on behalf of citizens of any state. State laws typically restrict enforcement action to suits on behalf of state residents, significantly decreasing the bite of any state suit and oftentimes creating substantial jurisdictional and evidentiary hurdles for the state.[2]

Fourth, Dodd-Frank empowers a broader group of state actors than just state attorneys general or other state enforcement agencies that might already have the power to bring suits under existing state consumer financial protection laws. In New York, for example, only the New York Attorney General can sue to enforce New York's prohibition against deceptive practices, but Dodd-Frank gives the authority to other state actors, including the NYDFS.

Finally, Dodd-Frank's grant of authority to state actors to enforce certain federal consumer finance regulations marks a significant departure from previous federal preemption rules and restrictions on state enforcement. For instance, state attorneys general could previously enforce only limited provisions of the Truth-in-Lending Act (TILA), whereas now state enforcers can also sue for violations of any TILA-related regulation. Dodd-Frank also expressly preserves state authority to enforce state consumer financial protection laws against any arguments of federal preemption. §5552(d). Federal law has gone from prohibiting state enforcement of certain federal consumer finance regulations to welcoming it.

Beyond expanding the scope and power of state enforcement of federal consumer finance rules, Dodd-Frank also encourages increased coordination at the state and federal level. Before a state attorney general or agency can file suit under Dodd-Frank, it must provide notice to the CFPB, which has the right to intervene and take over a lawsuit or appeal at any time. §5552(b).

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On Jan. 4, 2011, the CFPB and various state regulators signed a memorandum of understanding that permits information sharing between federal and state regulators, including information relating to examinations and consumer complaints. The CFPB more recently stated that it intends to "[e]ngage in regular consultation [with states] to identify mutual enforcement priorities…of laws that protect consumers of financial products or services."[3] The CFPB's intentions for information sharing is significant because its whistleblower program gives consumers another avenue to report complaints against local consumer finance companies, which can then be relayed to state enforcers.

This focus on information sharing has already led to coordinated enforcement actions between states and the federal government, including a settlement with Ocwen Financial by the CFPB and 49 state attorneys general concerning mortgage servicing misconduct, a coordinated action against Payday Loan Solutions by the CFPB and five state attorneys general enjoining the company from accepting consumer fees for not yet performed services and ongoing, coordinated lawsuits against CashCall for allegedly violating state interest rate caps in connection with online loans.[4]

States Flex §1042 Muscles

State enforcers have recently begun to embrace their enforcement role with regard to federal consumer financial protection laws. In 2013, New Mexico became the first state to use Dodd-Frank when it filed a series of suits to enforce federal Regulation Z of TILA. E.g., *State of New Mexico ex rel. Gary King v. HSBC Bank Nevada*, 1:13-cv-004504-RHS-KBM, (D.N.M. May 30, 2013). The actions were filed against banks and credit card companies for allegedly violating Regulation Z in the course of providing and selling consumers ancillary services for credit cards. Prior to Dodd-Frank, federal authority preempted state enforcers from enforcing TILA regulations against national banks and federal thrifts. But because Dodd-Frank gave the CFPB authority over TILA regulations, and Section 1042 authorizes state attorneys general to enforce CFPB regulations against national banks and federal thrifts, New Mexico's actions were cognizable.

New Mexico is not alone. In April of this year, the NYDFS became the first state regulator, other than a state attorney general, to file a claim under Dodd-Frank when it sued a subprime auto lender for unlawfully depriving consumers of millions of dollars by allegedly cutting off access to their online accounts. *Lawsky v. Condor Capital Corporation*, 14-cv-2863 (S.D.N.Y. 2014). The NYDFS complaint included three counts for violation of Dodd-Frank's UDAAP provision. The UDAAP violations included two charges against the company for theft of consumer funds for cutting off consumer access to their accounts and concealing the fact that positive refundable balances remained in the accounts, and for failing to protect consumer data by having undocumented information technology policies that were untested, inadequate, and regularly allowed employees to take home unprotected data tapes with consumers' personal identifying information. The complaint also asserted a separate charge against the company's CEO for knowingly assisting the company.

The NYDFS used Dodd-Frank to sue for damages on behalf of out-of-state residents. The NYDFS also used Dodd-Frank's remedy provision to secure a preliminary injunction against the company and to have a court-appointed receiver take over the company's operations. The action is also noteworthy because New York's comparable statutory prohibitions on unfair or deceptive consumer finance practices, like those of most states, only permit enforcement by the state's attorney general.

In March of this year, Illinois Attorney General Lisa Madigan used Dodd-Frank's UDAAP provision to bring an action against a payday lender. *State of Illinois v. CMK Investments*, No. 2014-ch-04694 (Ill. Cir Ct. 2014). The state alleged that the lender violated Dodd-Frank by "taking unreasonable advantage of a lack of understanding on the part of the consumer" of its payday loan product, which is a loan or loan advance offered primarily by non-depository institutions, involving limited or no underwriting, and typically resulting in a charge of a one-time fee that coincides with the borrower's next payday as opposed to a periodic interest rate as with a traditional loan. The lender allegedly charged borrowers an account protection fee that offered consumers little to no benefit, was too costly, and caused loans to exceed the state's interest rate cap.

Then in May, the Illinois Attorney General amended a complaint against a for-profit college to include Dodd-Frank UDAAP claims for unfair and abusive acts. *State of Illinois v. Alta Colleges*, No. 12-CH-01587 (Ill. Cir. Ct. 2012). The state alleged that the college failed to inform prospective students that most students enrolled in their programs defaulted on the financing that the institution offered and that the college induced students to sign financing agreements without informing students fully of their financing options.

In both the payday lender and for-profit college actions, Dodd-Frank gave Illinois additional remedial leverage, allowing the state to sue on behalf of non-state residents and to seek disgorgement and compensation for unjust enrichment that was not available under the Illinois Consumer Fraud Deceptive Trade Practices Act (ICFA) (815 ILCS 505/2).

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Finally, on May 16, Mississippi filed a complaint against Experian, which included a Dodd-Frank UDAAP claim alleging that the company engaged in deceptive acts in the marketing of its credit monitoring services and failed to provide consumers with full information from consumer credit reporting companies. *State of Mississippi ex rel. Jim Hood v. Experian Information Solutions*, Case No. 1:14-cv-00243-LG-JMR (May 16, 2014) (removed to S.D. Miss. on June 14). As relief, Mississippi seeks restitution, disgorgement and civil penalties under Dodd-Frank.

Strengthening State Laws

Even without the new powers granted by Dodd-Frank, state actors have shown an increased focus on consumer finance protections and consumer finance companies. Numerous states, including California, New York, Florida and Georgia, have strengthened their consumer protection laws since the financial crisis, passing new mortgage fraud and other statutes that arm state enforcers with new investigatory and enforcement powers over consumer finance companies. In addition, enforcement scrutiny has intensified, as evidenced, for example, by California's creation of a Mortgage Fraud Strike Force in May 2011 and the increased wave of mortgage servicing and other investigations initiated by the NYDFS.

Dodd-Frank, thus, recruits an eager set of actors to the task of enforcing robust federal consumer finance laws. Combined with the efforts of state and federal agencies to share information and coordinate enforcement actions, the result has been—and likely will continue to be—more instances of state enforcement of federal consumer finance laws.

1. See, e.g., Illinois Consumer Fraud and Deceptive Practices Act (815 ILCS 505/2); Maryland Consumer Protection Law (Md. Code, Commercial Law Article §13-301); New Jersey Consumer Fraud Act (N.J.S.A. §56:8-2).

2. See *People ex rel. Spitzer v. Direct Revenue*, No. 401325/06, 2008 WL 1849855 (N.Y. Sup Ct. March 12, 2008) (dismissing allegations of deceptive practices brought under Section 349 and finding allegations relating to out-of-state conduct beyond the scope of the statute).

3. Dec. 6, 2012, CFPB Statement of Intent for Information Sharing with State Banking and Financial Services Regulators.

4. *CFPB v. Ocwen Financial Corp.*, No. 13-cv-2025 (D.D.C. Feb. 26, 2014); *CFPB v. Payday Loan Debt Solution*, No. 12-cv-24410 (S.D. Fla. Dec. 12, 2012); *CFPB v. CashCall*, No. 13-cv-13167-GAO (D. Mass. March 21, 2014).