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Governor Cuomo Proposes Significant Expansion of Powers of New York Department of Financial Services

Brian K. Mahanna, David Gringer, Franca Harris Gutierrez, Brendan R. McGuire, and Susan Schroeder*

New York Governor Andrew M. Cuomo's budget legislation proposed to significantly expand the powers of the New York State Department of Financial Services, the state's banking and insurance regulator. This article discusses the proposal's noteworthy elements; however, just before publication, the New York State Legislature enacted a budget that did not include this proposal. As the proposal represents the governor's vision for financial regulation and may be revived at a later date, we nevertheless think readers would benefit from the authors' analysis.

In legislative language accompanying his proposed budget, New York Governor Andrew M. Cuomo proposes to significantly expand the powers of the New York Department of Financial Services ("DFS"), the state's banking and insurance regulator. The governor's proposal would enlarge the department's mission beyond banking and insurance oversight, transforming DFS into perhaps the most powerful state regulator in the nation, with new and broad jurisdiction and substantial enforcement powers over consumer products and services, business to business arrangements, and securities and investment advice.

Though significant in its scope, the Cuomo proposal is in many respects unsurprising. The governor created DFS in 2011 upon merging the state's Banking Department and Insurance Department; he initially sought to give DFS powers under the Martin Act, the state's broad "blue sky" securities statute, but the Legislature declined to do so. Governor Cuomo has, however, expanded DFS's jurisdiction in other ways in the years since its creation, including by granting it powers to police the state's student loan servicing industry.[1] And both the governor and DFS Superintendent Linda Lacewell have repeatedly expressed the view that the Trump Administration has mothballed the federal

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[1] 3 NYCRR 409.

Consumer Financial Protection Bureau ("CFPB"), leaving an oversight and enforcement gap that DFS should fill. This proposal gives DFS the tools to do so.

As the New York State fiscal year begins on April 1, the Legislature will decide by March 31, the end of the current fiscal year, whether to adopt, amend, or reject the governor's proposal. If the governor's proposal passes, companies doing business in New York – particularly those that offer products and services to New York consumers or securities in New York markets – should expect DFS to vigorously assert its new authority, including in the areas in which it would overlap with and occasionally surpass that of the New York Attorney General ("AG").

BACKGROUND

At Governor Cuomo's behest, the Legislature created DFS in 2011 through the merger of the New York State Insurance Department and New York State Banking Department. According to DFS, the department supervises approximately 1,500 banking and other financial institutions with assets totaling more than $2.6 trillion and 1,400 insurance companies with assets totaling more than $4.7 trillion.[2]

The Legislature established DFS in the wake of the financial collapse of 2008, when widespread fraud in financial markets came to light. As a result, Governor Cuomo initially proposed not only to merge the two departments, but also to give the new entity the power to investigate securities fraud under the Martin Act,[3] which, among other things, prohibits fraud or misrepresentation in the public offer, sale and purchase of securities and commodities. While the Legislature declined to give DFS this additional authority, it did enact Financial Services Law ("FSL") Section 408, which empowers DFS to assess penalties against companies engaging in "intentional fraud" or "intentional misconduct" in connection with the offering or sale of a "financial product or service."

Traditionally, the New York Attorney General's Office, with its broad investigative and enforcement powers under the state's Executive Law and General Business Law ("GBL"), has policed the state's securities markets and protected its consumers from fraud. As the state's securities regulator, the AG enforces New York's Martin Act. And, like state attorneys general across the country, the New York AG also investigates and brings enforcement actions

[2] Department of Financial Services, "About Us," https://www.dfs.ny.gov/our_mission.

[3] N.Y. Gen. Bus. Law §§ 352 *et seq*.

against entities engaging in deceptive acts or practices that victimize state consumers, here under GBL Sections 349 and 350.

Over the past year, however, Governor Cuomo and DFS have made clear that they are increasingly focused on protecting consumers from fraud and sharp practices they believe are frequently being perpetrated on New York residents by commercial interests. This article provides additional context for the governor's proposal and highlights the ways in which it goes beyond solely providing DFS with additional consumer fraud powers.

DFS, Superintendent Lacewell, and the New Consumer Protection and Financial Enforcement Division

In February 2019, Governor Cuomo appointed Linda Lacewell, a former state and federal prosecutor who most recently served as the Governor's Chief of Staff, Superintendent of DFS. On April 29, 2019, Lacewell announced a significant reorganization of the DFS, creating the new Consumer Protection and Financial Enforcement Division (the "CPFE" Division) by combining seven previously separate divisions and units under a single deputy superintendent.[4] Lacewell appointed Katherine Lemire, another former state and federal prosecutor, to head the new division.

In an interview Lacewell gave shortly thereafter, she stated that her focus as Superintendent would be on data privacy and consumer protection, asserting that the CFPB no longer vigorously polices consumer fraud.[5] "Where CFPB steps down, DFS has to step up," Lacewell told *The Wall Street Journal*.

Governor Cuomo's 2020 State of the State Address

On January 8, 2020, Governor Cuomo delivered his 2020 State of the State address. In the accompanying policy book, the governor offered "a broad consumer protection agenda"[6] that included proposals to:

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[4] Department of Financial Services, Press Release, "Acting DFS Superintendent Lacewell Announces Appointment of Katherine Lemire as Executive Deputy Superintendent of Newly Created Consumer Protection & Enforcement Division," (April 29, 2019), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1904291. The previously separate units and divisions were: the Enforcement Division; the Investigations and Intelligence Division; the Civil Investigations Unit; the Producers Unit; the Consumer Examinations Unit; the Student Protection Unit; and the Holocaust Claims Processing Office. *Id.*

[5] Jimmy Vielkind, "New York's Top Financial Regulator Wants to Protect Consumers," The Wall St. Journal (July 8, 2019), https://www.wsj.com/articles/new-yorks-top-financial-regulator-wants-to-protect-consumers-11562587212.

[6] State of New York, Press Release, "Governor Cuomo Outlines 2020 Agenda: Making Progress Happen" (Jan. 8, 2020), https://www.governor.ny.gov/news/governor-cuomo-outlines-2020-agenda-making-progress-happen.

(1) "[M]ake New York State consumer protection law consistent with federal law,"

(2) "[E]liminat[e] unnecessary exemptions for consumer financial products and services,"

(3) "[C]lose loopholes and create a level playing field for regulated entities," and

(4) "[A]mend[] the Insurance Law to increase maximum fines for violations of law and ensure DFS has the authority to maintain civil enforcement actions to address violations."[7]

The following day, Lacewell announced the creation of a new "Consumer Protection Task Force" within DFS and labeled 2020 "the Year of the Consumer."[8] DFS soon after announced the appointment of Leandra English, the former Deputy Director of the CFPB, as a Special Policy Advisor. English will "manage and develop the Department's portfolio of policy initiatives involving consumers, financial services, and other issues."[9]

PROPOSAL

The details of Governor Cuomo's proposal to increase DFS's powers are found within Part NN of his proposed FY 2021 New York State Executive Budget.[10] The changes could have significant consequences for a wide range of industries and entities that do business in New York, far beyond the banking and insurance industries that DFS traditionally regulates. It should also be noted, however, that the proposal expands DFS's powers with respect to these regulated industries as well.

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[7] *Id.*; *see also* Governor Andrew M. Cuomo, Making Progress Happen: 2020 State of the State, https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/2020StateoftheStateBook.pdf (policy proposal book accompanying State of the State address).

[8] Department of Financial Services, Press Release, "Financial Services Superintendent Linda A. Lacewell Announces Creation of Consumer Protection Task Force, Reinforcing Department's Commitment to Protect New Yorkers," https://www.dfs.ny.gov/reports_and_publications/press_releases/pr2001091.

[9] Department of Financial Services, Press Release, "DFS Superintendent Lacewell Announces Appointment of Former CFPB Deputy Director Leandra English to Department of Financial Services Leadership Team" (Jan. 14, 2020), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202001141.

[10] *See* FY 2021 New York State Executive Budget, Transportation, Economic Development and Environmental Conservation, Article VII Legislation, Part NN (Jan. 21, 2020), https://www.budget.ny.gov/pubs/archive/fy21/exec/artvii/ted-bill.pdf.

The most noteworthy elements of the proposal follow.

Expanding the Definition of "Financial Product Or Services," to Include Offering Securities or Investment Advice, Thereby Making DFS a Securities Regulator

The definition of "financial product or service" under FSL Section 104 would be expanded to include "the sale or provision to a consumer or small business of any security, investment advice, or money management device."[11] While DFS currently has broad regulatory authority over insurers and banks in the state, it is not the state's securities regulator; the New York AG is. The New York AG regularly deploys her Martin Act authority to police New York's markets, including in relation to the offering of investment advice. The New York region's prominent role in global capital markets and the fact that many popular securities exchanges are based in Manhattan combine to give the New York AG jurisdiction to pursue cases that are national—or even international—in scope and impact. By adding securities to the definition of "financial product or service" and giving DFS the power to regulate the provision of investment advice, the proposal would effectively make DFS another securities regulator.[12]

Expanding the Scope of DFS's UDAAP (Unfair, Deceptive, or Abusive Act or Practice) Powers

Presently, FSL Section 408 gives DFS the ability to levy civil penalties on entities which, after notice and a hearing, are found to have engaged in "any *intentional* fraud or *intentional* misrepresentation *of a material fact* with respect to a financial product or service or involving any person offering to provide or providing financial products or services."[13] The proposal would amend this provision in four significant ways:

(1) It would remove the words "intentional" and "of a material fact," leaving unlawful "any fraud or misrepresentation."[14]

(2) It would add "or unfair, deceptive, or abusive act or practice" to the scope of activities DFS may penalize.[15]

(3) It would eliminate the previous statutory exceptions to the definition of "financial product or service," which excepted from DFS's authority such products or services already regulated by another state

[11] *Id.* § 1.

[12] *Id.*

[13] N.Y. Fin. Serv. § 408(a)(1)(A) (emphasis added).

[14] *See* Part NN, *supra* note 10, § 6.

[15] *Id.*

or federal agency.[16]

(4) It would expand the subject of the prohibition to "any service provider utilized by any person offering to provide or providing financial products or services."[17]

The collective effect of these four changes would be to give DFS sweeping powers that in some respects mimic, but in others go beyond, that which the New York AG possesses under the GBL. GBL Section 349, the state's general consumer protection statute, prohibits "deceptive acts or practices" and gives the AG broad authority to enjoin such practices and penalize entities engaging in them, even without making a showing of intent to deceive.[18] GBL Section 349 seeks to avoid regulatory overlap by establishing that entities acting in accordance with federal rules or regulations cannot be the subject of an action under the law.[19]

Governor Cuomo's proposal similarly drops the intent requirement of FSL Section 408, while also giving DFS the power to penalize "unfair" or "abusive" practices. The elimination of the statutory exceptions to the definition of "financial products or services" increases the potential for overlapping – and potentially conflicting – regulatory behavior, though ordinary federal preemption principles would still apply.[20] Finally, "service provider" is not defined within the FSL. Thus, on the plain text of the proposed statute, any company providing a service that is in turn utilized to commit any fraud or misrepresentation related to a financial product or service, even an unintentional one, could potentially be liable.

Expanding DFS's Power to Include Business-to-Business Transactions

The proposed definition of "financial products or services" under FSL Section 104 also includes those offered or sold to *small businesses*, defined as any independently owned and operated business with less than $10 million in annual gross receipts or sales and with fewer than 100 employees.[21] This provision would thus create regulatory oversight of business-to-business transactions; companies that sell to other companies had previously been largely

[16] *Id.* § 1.

[17] *Id.* § 6.

[18] N.Y. Gen. Bus. § 349(a).

[19] *Id.* § 349(d).

[20] The term "financial" in "financial products or services" is not itself defined, and the governor's proposal does not seek to do so.

[21] Part NN, *supra* note 10, §§ 1-2.

insulated from the jurisdiction of state attorneys general or other state regulators policing fraud using their consumer protection powers. It is relatively novel for an agency – state or federal – to patrol business-to-business transactions for fraud or misconduct. For example, outside of small-business lending practices, the CFPB has not focused on protecting small businesses.

Giving DFS the Power to Seek Restitution in Any Administrative or Judicial Proceeding

The proposed legislation would add a new section to the FSL allowing DFS to order the individual or entity subject to "any administrative proceeding or judicial action brought under this chapter, the banking law, or the insurance law" to "make restitution to all consumers harmed by such individual or entity's conduct." Restitution could be ordered "in addition to any other penalty or sanction imposed by law."[22]

Increasing the Penalty Provisions and Providing Additional Criteria to Enable the Assessment of Greater Penalties

Under current law, DFS can assess penalties of no more than $5,000 per transgression. The proposal changes the maximum civil penalty under FSL Section 408 from $5,000 per offense to "the greater of five thousand dollars for each offense; a multiple of two times the aggregate damages attributable to the offense; or a multiple of two times the aggregate economic gain attributable to the offense."[23]

Separately, the legislation would amend Section 109 of the Insurance Law to increase the penalty for willful violations of the insurance laws from $1,000 to $10,000 for each offense.[24]

Shifting the Expenses of DFS Examinations of Regulated Entities to the Entities

As a largely self-funded agency, DFS levies annual assessments on regulated entities per FSL Section 206 (formerly Insurance Law Section 332) in exchange for the privilege of being permitted to conduct business in New York.[25] Governor Cuomo's proposed legislation would also pass along "[t]he expenses of every examination of the affairs of any regulated person" to be "borne and paid by such regulated person so examined" unless otherwise excused by the

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[22] *Id.* § 4.

[23] *Id.* § 6.

[24] *Id.* § 7.

[25] *See* Department of Financial Services, "Annual Assessment Charges," https://www.dfs.ny.gov/apps_and_licensing/annual_assessment_charges (last visited Feb. 8, 2020).

comptroller and superintendent.[26] Most entities regulated by DFS pay the cost of the regulator's assessments under the Insurance or Banking laws; however, those licensed pursuant to the FSL (e.g., virtual currency entities) do not. The proposed amendment to the FSL would extend the requirement to such entities.[27]

Other Proposed Changes

Finally, the draft amendments would also expand the reach of the FSL in two other ways.

First, the proposal would extend the definition of "financial product or service" in FSL Section 104 to include:

(1) "[A]ny warranty sold or provided to a consumer or small business or any guarantee or suretyship provided to a consumer";

(2) "[A]ny merchant cash advance provided to a consumer or small business"; and

(3) Any related contract provisions.[28]

Second, the proposal adds a new section to the FSL that makes explicit that these laws apply to any person or entity that is required by the FSL or insurance or banking laws to be licensed, even if the person or entity does not possess the required license.[29]

CONSEQUENCES AND TIMELINE

While the ultimate impact of these changes would be dependent on the priorities of DFS and the aggressiveness with which it pursues them, in the aggregate the changes would give DFS a suite of powers far surpassing those of the ordinary state banking and insurance regulator. It remains to be seen how a newly empowered DFS would interact with sister state and federal agencies. The governor's proposal is premised on the idea that federal regulators have not been sufficiently vigorous in pursuing fraud, though DFS may seek strategic partnership where federal agencies possess additional enforcement tools. And the fact that DFS would ordinarily be represented in any judicial enforcement action by the New York AG, which has independent consumer and investor protection powers, is likely to be one factor in a shifting dynamic between two aggressive state agencies with overlapping jurisdictions.

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[26] *See* Part NN, *supra* note 10, § 3.

[27] *See id.*

[28] *Id.* § 1.

[29] *Id.* § 5.

Companies that do business with New York consumers or small businesses, or offer securities or investment advice in New York, could thus find there is a new state regulatory sheriff in town very soon.