DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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ARIZONA LAUNCHES REGULATORY SANDBOX FOR FINTECHS

The Arizona Governor signed Arizona H.B. 2434 into law on Thursday, establishing Arizona as the first state to create a regulatory sandbox program ("Sandbox") for financial companies offering innovative products.

The Sandbox allows a person to temporarily test innovative financial products or services on a limited basis without otherwise being licensed or authorized to act under the laws of Arizona. A person may apply to enter the Sandbox by submitting an application to the Arizona Attorney General. The application must contain a description of the innovation desired to be tested, as well as a sufficient plan to test, monitor and assess the innovation while ensuring consumers are protected from a test's failure.

If an applicant is approved to be a Sandbox participant, the participant has 24 months after the date of approval to test the innovative financial product or service, with the possibility of a one-year extension. The participant may only test products with Arizona residents and generally not more than 10,000 consumers may transact through or enter into an agreement to use the innovation, although that number can be expanded with adequate capital and risk management.

Disclosure and record keeping requirements apply and federal approvals will be needed. The Arizona Consumer Fraud Act and statutory limits and rate caps remain applicable. A reciprocity provision may assist in developing multistate offerings. Thus, passage of the Sandbox legislation is simply an initial step, but could serve as a useful model for other legislation.

The Sandbox program was modeled after a similar successful initiative in the United Kingdom. The lack of action on a similar sandbox-approach from federal financial regulators has pushed states to establish their own regulatory sandbox programs. The Illinois legislature has introduced a bill that mirrors Arizona's Sandbox program.

While the Consumer Financial Protection Bureau has promoted Project Catalyst as an option to promote innovation, Project Catalyst suffers from significant restrictions and risks. *See, e.g.,* our ALERTS of March 7, 2016 and October 23, 2014.

Our firm has substantial experience with fintechs, alternative vehicles for delivering financial services and licensing on a multistate basis. We can help advise on the strategic considerations of obtaining a Sandbox registration or assist in the Sandbox program application process if deemed appropriate for your situation. ❑

✧ *Mike Tomkies and Lindsay Valentine*

"TRUE CREDITOR" CASES REMANDED TO COLORADO STATE COURT

The U.S. District Court for the District of Colorado has been busy this month addressing "true creditor" jurisdictional questions in connection with two cases filed by the Administrator of the Colorado Uniform Consumer Credit Code ("Administrator") against bank partnership programs in state court. *See Meade v. Avant of Colorado, LLC*, No. 1:17-cv-00620 (D. Colo. Mar. 1, 2018); *Meade v. Marlette Funding, LLC*, No. 1:17-cv-00575 (D. Colo. Mar. 21, 2018).

Removal & Remand: Nonbank Cases

In each case, the nonbank-defendant removed the case to federal court arguing that federal court has jurisdiction over the case because Section 27 of the Federal Deposit Insurance Act (12 U.S.C. § 1831d) ("Section 27") "completely preempts" state usury claims against a non-bank assignee of a bank loan. The Administrator filed a motion to remand each case to state court.

The district court granted the Administrator's motion to remand concluding that complete preemption under Section 27 does not apply to claims against non-bank entities even if the non-bank has a close relationship with a state bank. In the *Avant* order, the court explained that "complete preemption" is distinct from "ordinary preemption." When complete preemption exists, a federal claim effectively displaces the state cause of action. Consistent with other court decisions, the district court ruled that Section 27, which governs "state banks", does not manifest a Congressional intent to allow removal of actions involving state claims against a non-bank entity to federal court. According to the court in *Avant*, absolutely nothing prevents the non-bank defendant from asserting federal rate preemption and other available defenses, such as the valid when made doctrine, in state court.

Dismissal: Bank Cases

Each partner bank separately filed a complaint against the Administrator in federal court seeking (i) a declaratory judgment that

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Section 27 preempted Colorado usury laws and (ii) a permanent injunction against the Administrator to prevent her from enforcing Colorado usury laws against the bank or its assignees, partners, program or servicers. *See Cross River Bank v. Meade*, No. 1:17-cv-00832 (D. Colo. Mar. 22, 2018); *WebBank v. Meade*, 1:17-cv-00786 (D. Colo. Mar. 19, 2018). The court dismissed each bank's complaint without prejudice, again based on jurisdictional grounds, specifically citing a U.S. Supreme Court doctrine that a federal court may not interfere with state court proceedings by granting equitable relief when such relief could adequately be sought before the state court. Thus, the federal court abstained from interfering in the remanded *Avant* and *Marlette* state court cases. Each bank remains free to seek redress in Colorado state court.

DT Comments

The federal court rulings were consistent with prevailing precedents. The federal court issued no substantive ruling on whether the nonbanks are the "true creditor" of the program or violated Colorado usury law. Those issues are for the state court to determine.

The defendants will now need to address the Administrator's factual allegations, defend their respective program structures and develop their ordinary preemption arguments, in state court.

We will continue to follow each case on remand. Please contact us if you have any questions. ❑

✧ *Mike Tomkies, Susan Manship Seaman and Lindsay Valentine*