AMERICAN FINANCIAL SERVICES ASSOSCIATION
LAW COMMITTEE

PAYMENT CARD COMMITTEE
REPORT ON RECENT DEVELOPMENTS
MAY 20-21, 2019

I. The Death of Valid When Made?: A Post-*Madden* World

https://www.dltlaw.com/Alerts/AN-UNFORTUNATE-END-MADDEN-V-MIDLAND-FUNDING-SETTLES.pdf

II. The Death of Exportation?: The Empowering States' Rights to Protect Consumers Act

On 4/4/19, Senators Sheldon Whitehouse (D-R.I.), Elizabeth Warren (D-Mass.), Jeff Merkley (D-Ore.), and Jack Reed (D-R.I.) reintroduced the Empowering States' Rights to Protect Consumers Act which would amend the Truth in Lending Act to authorize states to "reinstate" their interest rate caps for credit cards and other loans by tying rates to where the consumer resides (regardless of lender-type).

III. True Creditor Update

The trial date in *Avant* is scheduled for July 29th; the trial date in *Marlette* is set for October 21st.

IV. Fintech

A. Bank Charter Developments

B. OCC Announces Innovation Pilot Program

On April 30, the Office of the Comptroller of the Currency (OCC) announced a proposed Innovation Pilot Program to provide eligible entities with regulatory input early in the testing of innovative activities that could present significant opportunities or benefits to consumers, businesses, financial institutions, and communities. The OCC is soliciting public comment for 45 days. OCC-supervised financial institutions eligible for the program specifically include institutions engaging third parties to offer innovative products.

https://www.occ.gov/news-issuances/news-releases/2019/nr-occ-2019-42.html?utm_source=dlvr.it&utm_medium=twitter#

https://www.occ.gov/topics/responsible-innovation/occ-innovation-pilot-program.pdf

https://www.occ.gov/topics/responsible-innovation/occ-innovation-pilot-program-faqs.pdf

C. A Comeback For Industrial Loan Companies

D. New York Fed Fintech Advisory Group

On March 22nd, the Federal Reserve Bank of New York released a statement about its newly created Fintech Advisory Group. The stated goal of the group is to present views and perspectives on the emerging issues related to financial technologies, the application and market impact of these technologies, and the potential impact on the New York Fed's ability to achieve its missions. The first meeting was slated for April 1.

https://www.newyorkfed.org/newsevents/news/aboutthefed/2019/20190322

E. Federal Reserve Banks Issue Small Business Study

On April 16, 2019, the several Federal Reserve Banks issued a small business study. Among the findings from a survey of businesses, the banks found:

- Two-thirds of the firms relied on personal finances to cover their costs, while 40% of firms took out additional debt.
- Applications to online lenders continued their growth trend with 32% of applicant firms turning to such lenders in 2018, up from 24% in 2017, and 19% in 2016. These applicants expected online lenders would make faster funding decisions, would be more likely to provide funding, and would not require collateral.
- Applicants who sought funding at large and small banks cited an existing relationship as the primary factor in their choice of lender. The also tended to be more patient (waiting as much as a month for funding) and be more creditworthy.

https://www.newyorkfed.org/newsevents/news/regional_outreach/2019/20190416a

https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/SBCS-Employer-Firms-Report

https://www.fedsmallbusiness.org/survey/2019/report-on-employer-firms

F. Arizona Has Modified Its Sandbox Legislation

On April 1, the Arizona Governor signed a bill that revises aspects of Arizona's regulatory sandbox, which is the first operating state sandbox in the United States. *See* 2019 Arizona H.B. 2177. Arizona launched its sandbox in October 2018 and has three companies participating in the sandbox. This is the first time Arizona has made statutory adjustments to its sandbox since the sandbox's launch.

https://www.dltlaw.com/Alerts/ARIZONA-REVISES-ITS-REGULATORY-SANDBOX.pdf

G. FTC and Avant Settle

The Federal Trade Commission and Avant, LLC have settled charges that Avant engaged in deceptive and unfair loan servicing practices, such as imposing unauthorized charges on consumers' accounts and unlawfully requiring consumers to consent to automatic payments from their bank accounts. Among other things, the Commission alleged that Avant:

- Failed to properly and timely credit payments made by check;
- Provided inaccurate payoff quotes to consumers;
- Collected additional amounts even after consumers paid the quoted payoff amount; and
- Violated the Telemarketing Sales Rule and the Electronic Fund Transfer Act by requiring borrowers to agree to recurring automatic debits of their bank account as a condition of obtaining a loan.

See FTC v. Avant, LLC, No. 19-cv-2517 (filed Apr. 15, 2019). Dissenting views expressed concerns that the FTC was exceeding its authority in bringing the TSR and EFTA claims.

https://www.ftc.gov/news-events/press-releases/2019/04/online-lending-company-agrees-settle-ftc-charges-it-engaged

H. Kabbage, Inc. and Celtic Bank Sued Over Rates in New York

On April 5, 2019, AF Trucking, Inc. filed suit against Kabbage, Inc. and Celtic Bank in New York seeking a declaratory judgement that the rates charged on loans originated by the bank exceed New York's criminal usury rate of 25% and that affected loans should be voided. *AF Trucking, Inc. v. Kabbage, Inc. and Celtic Bank Corporation*, No. _____, (N.Y. Sup. Ct., Orange Cty, filed April 8, 2019).

V. Cashless Bans / Cash Mandates Update

In the past few months additional states and cities have begun to introduce laws mandating that merchants accept cash. Measures have recently been introduced in Connecticut, Oregon, Rhode Island, Chicago and San Francisco.

Are Cryptocurrencies on Their Way to Becoming a Trusted Payment Alternative?

By Michael C. Tomkies and Lindsay P. Valentine

Introduction

The cryptocurrency market received a lot of attention and scrutiny in 2018. The nature of cryptocurrencies and how they should be regulated continues to be debated. An explosion of initial coin offerings has added to the confusion. A new type of cryptocurrency, the stablecoin, emerged in the latter half of 2018 as a digital coin that could be used as common currency for digital transactions. This article explores whether cryptocurrencies can emerge as a trusted payment alternative to traditional fiat currency.

Digital Payments Steadily Increasing

According to a February 2018 survey, U.S. mobile wallet adoption has grown from 27 percent in the first quarter of 2016 to 34 percent in the first quarter of 2018.[1] According to the data and research firm eMarketer, more than one-third of smartphone users age 14 and older will use a mobile phone to pay for a purchase at a physical point of sale (POS) at least once every six months.[2] By 2021, it is estimated the number of mobile POS users will increase to 39.8 percent of smartphone users.[3] The increase of mobile payments at POS terminals can be attributed to the expansion of global digital payment facilitators, including Apple Pay, Android Pay, Google Pay and Samsung Pay, as well as growing retailer acceptance of mobile payments.[4] In the United States, the Starbucks mobile application (App) is the most popular proximity mobile payment App, with 23.4 million people ages 14 and over using the app to make a POS purchase at least once every six months.[5] Retail and corporate customers now have an increasing number of choices in digital payment solutions offered through e-commerce players and financial technology companies (Fintechs). As consumers continue to accept and gravitate toward digital mobile payments, there is an opportunity for virtual cryptocurrencies to become an alternative digital payment method that consumers carry in their mobile wallets.

The white paper (Bitcoin Whitepaper) that introduced the concept of bitcoin proposed that bitcoin be used as an electronic payment system based on cryptographic proof allowing any two willing parties to transact directly with each other without the need for a trusted third party.[6] Bitcoin was the first global cryptocurrency introduced and it was created as an alternative medium of payment and store of value. Bitcoin has a hard limit on the eventual number of bitcoins and requires "miners" to find a solution to create a bitcoin. Since the introduction of bitcoin, new types of cyptocurrencies have been introduced as an alternative payment method. Ripple, Ether, and Litecoin are all cryptocurrencies that were introduced as a global payment method.[7] According to CoinMarketCap.com, there are more than 2,080 different coins today.[8]

PayPal and Venmo are popular Fintech companies that allow customers to make quick person-to-person transfers from their smartphones. PayPal not only uses a consumer's credit card or bank account information to facilitate transfers and payments, but it also accepts cryptocurrencies as a form of payment.[9] E-commerce retailers, such as Overstock, Expedia, and Microsoft, are also accepting popular virtual coins, such as bitcoin and

Michael C. Tomkies is a partner with Dreher Tomkies LLP in Columbus, Ohio. His national practice is concentrated in the area of financial services, including federal and multistate regulation and compliance, consumer and commercial lending, multistate program development, ecommerce, and other matters. He is a graduate of Hampden-Sydney College and Harvard Law School, a Regent of the American College of Consumer Financial Services Lawyers, and a member of the Governing Board of the Conference on Consumer Finance Law.

Lindsay P. Valentine is an associate with Dreher Tomkies LLP. Lindsay works on assignments in all areas of the Firm's practice, specifically addressing federal and state regulatory compliance issues with respect to consumer and commercial lending. She received a J.D. from The Ohio State University College of Law and a B.S. from The University of Akron. This Article represents the views of the authors and not the firm with which they are associated.

ether[10], as a method of payment. Even an apartment rental platform, ManageGo, based out of Brooklyn, New York, offers landlords, and tenants the option to pay rent with bitcoin.[11]

However, one issue likely impeding broader merchant and user acceptance of cryptocurrencies as a form of payment is the instability of the cryptocurrency market.

Stablecoin—The Solution for a Cryptocurrency Payment Method?

A few Fintechs have responded to volatility concerns by introducing the "stablecoin." A stablecoin is a cryptocurrency that is pegged to the value of an underlying asset. The value of the cryptocurrency is kept stable in relation to the underlying asset.[12] According to the crypto company Blockchain, there is a total of 57 identifiable stablecoins, 39 percent of which are live.[13]

There are three categories of stablecoins: (i) traditional collateral-backed coins (*i.e.*, asset-backed, fiat-backed, or asset-and-fiat-backed), (ii) crypto collateral-backed coins (*i.e.,* cryptoasset-backed or crypto-and-fiat-backed) and (iii) algorithmic-supported coins (*i.e.,* fee-backed or hybrid). The value of the coins relies on the collateral that backs the coins. Coins that are backed by on-chain collateral rely on the conglomerate of cryptocurrenies that support the coin. Thus, coins that are backed by crypto assets remain subject to the general volatility of the underlying cryptocurrencies. According to Blockchain, 54 percent of the asset-backed stablecoins utilize on-chain collateral, such as ether, versus 46 percent that utilize off-chain collateral like the U.S. dollar. Blockchain reported that the total market value of all stablecoins is $3 billion, or 1.5 percent of the total market value of all cryptoassets. The stablecoin Tether is the second most actively traded cryptocurrency, with bitcoin leading the way. Tether is backed by the U.S. dollar, but there is doubt surrounding Tether's U.S. dollar reserve as the company has yet to agree to a transparent audit. Even with this doubt, Tether has proven to be very stable and has seen little variation from its peg, the U.S. dollar.[14]

In September 2018, the New York State Department of Financial Services approved the issuance of two cryptocurrencies, the Gemini dollar and the Paxos Standard (PAX token).[15] Both coins are considered stablecoins because each coin is a price-stable currency that matches the value of the U.S. dollar. The Gemini dollar and the PAX token are both issued by New York trust companies. Both tokens are redeemable one-to-one with the U.S. dollar. A consumer may convert U.S. dollars into either the Gemini dollar or PAX token by creating an account with either cryptocurrency company. Then the consumer may withdraw the Gemini dollars or PAX tokens to an Ethereum address the consumer specifies. The consumer may also convert the Gemini dollar or PAX token into U.S. dollars at any time.[16] The Gemini dollar whitepaper (Gemini Whitepaper) suggests that the inherent risk of cryptocurrencies can be resolved by forming a network of trust in the Gemini dollar by linking licensed financial institutions and examiners.[17] This reliance and trust in a centralized entity creates a counterparty risk in fiat-collateralized stablecoins that if the financial institution fails or is exposed to certain liabilities, the value of the fiat-backed stablecoins that depends on the centralized entity will fail or be exposed to the same liabilities and risk. Both stablecoins operate under the supervision of the New York State Department of Financial Services.

Switzerland and the United Kingdom are also involved with the stablecoin space. The Tiberius Coin was introduced by a Swiss asset manager and commodities trader and it is backed by a combination of assets: gold, platinum, tin, nickel, cobalt, aluminum, and copper.[18] The Tiberius Coin is sold under Swiss law instead of through an initial coin offering and will be tradable on the Estonia-based LATOKEN exchange. In the United Kingdom, the London Block Exchange released the LBXpeg, which is the first cryptocurrency to be tied to the value of the pound sterling, held in an auditable U.K. bank account.[19] As the stablecoin market continues to mature, it is likely that other countries will introduce their own version of a stablecoin.

Establishing stability may set off a virtuous cycle of greater acceptance.

The Widening Acceptance of Cryptocurrenies as a Payment Method

On November 26, 2018, the state of Ohio became the first U.S. state to accept bitcoin as a payment for taxes.[20] The Ohio Treasurer's office launched the website: OhioCrypto.com, which allows taxpayers to pay their state business taxes with cryptocurrency. The Ohio Treasurer stated that its office is working to help make

Ohio a national leader in blockchain technology. The Arizona, Georgia, and Illinois state legislatures have also introduced bills that would allow residents to pay state taxes with cryptocurrencies, but those bills have not yet been passed into law.[21] Even if states are beginning to approve the use of certain cryptocurrencies, the question remains whether more businesses will accept cryptocurrencies as a form of payment for goods and services.

In August 2018, the U.S. Patent & Trademark Office approved digital payments firm Square Inc.'s (Square) application to patent a system that allows customers to pay in any currency of their choice while merchants who use the Square technology can receive such payments in a currency of their choice.[22] If Square adds cryptocurrency payments to its present POS system, millions of merchants that use Square will then be able to accept cryptocurrency without having to use a separate payment processor. In a survey of approximately 100 U.S. merchants that use Square's technology, 60 percent said they would be willing to accept Bitcoin in lieu of dollars.[23]

The Future of Cryptocurrencies

October 2018 marked the 10-year anniversary of bitcoin and the introduction of cryptocurrencies. (The current U.S. banking system, which features one central bank and an organized national banking system, was introduced by the Federal Reserve Act of 1913 over 105 years ago.) The nascent cryptocurrency market has the potential to transform the U.S. financial industry but remains hampered by a muddled, regulatory environment. States have introduced legislation that attempts to regulate cryptocurrencies but there is no uniformity among the legislation in part because there is no consensus on the nature of cryptocurrencies.[24] The Commodity Futures Trading Commission (CFTC), Internal Revenue Service, Securities and Exchange Commission (SEC), and U.S. Department of Treasury have provided conflicting statements on what each agency believes a cryptocurrency is.[25] Insofar as the different agencies focus on different aspects, they may all be correct but harmonization is needed.

On December 6, 2018, two bills relating to the virtual currency market were introduced in the U.S. Congress.[26] Both bills task the CFTC, in consultation with the heads of the SEC and other relevant federal agencies, with the responsibility of submitting a report to select U.S. House of Representative committees that provides details on (i) the state of virtual currency markets and ways to promote American competitiveness and (ii) ways to promote fair and transparent virtual currency markets by examining the potential for price manipulation. Both bills also define the term "virtual currency" as a digital representation of value that does not have legal tender status and that functions as a medium exchange, unit of account or a store of value. If these bills are passed into law they would strengthen the cryptocurrency market by providing a more uniform regulatory scheme that reflects cryptocurrencies' unique and varied characteristics.

As the cryptocurrency market continues to develop, different uses for cryptocurrencies are emerging. The different types of cryptocurrencies should be subject to flexible regulations that are tailored to recognize and regulate different purposes. Initial coin offerings, for example, should be regulated like securities insofar as the primary purpose of these coins is to raise money and investors receive coins that may be of speculative value in the future,[27] but stablecoins operate primarily as an alternative payment method to fiat currency. To succeed as an alternative payment method, consumers and businesses must have confidence in cryptocurrency. A common regulatory scheme addressing cryptocurrency use as currency should be introduced on the state level by state departments that regulate financial institutions, or at the federal level. A consistent regulatory scheme (whether multistate or federal) that, for example, subjects stablecoins to an annual audit performed by a primary regulator to verify that coins are in fact backed by assets as represented can instill greater public confidence in stablecoins.

Cryptocurrencies can allow consumers and businesses to transact globally without the risks and delays of other currencies. If well regulated, stablecoins in particular may allow consumers to adopt and utilize cryptocurrencies more widely as a form of payment.

Notes

1. Krista Garcia, *The Battle for Mobile Wallet Dominance Continues*, eMarketerRetail (May 7, 2018), *https://retail.emarketer.com/article/battle-mobile-wallet-dominance-continues/5af098e6eb-d40003a0c24689*.
2. *eMarketer Releases New Global Proximity Mobile Payment Figures,* eMarketerRetail (Feb. 12, 2018), *https://retail.emarketer.com/*

article/emarketer-releases-new-global-proximity-mobile-payment-figures/5a821109ebd4000744ae4118.

3. *Id*.
4. *Id*.; Garcia, *supra* note 1.
5. *Starbucks App Leads Mobile Payment Competitors,* eMarketerRetail (May 22, 2018), *https://retail.emarketer.com/article/starbucks-app-leads-mobile-payment-competitors/5b02fc5aebd40003a0c246b1*.
6. Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, bitcoin (Oct. 31, 2008), *https://bitcoin.org/bitcoin.pdf*.
7. Jeffrey D. Mills & Julia C. Wirts, *Is Bitcoin Moving from Fad to Mainstream?,* PNC (Sept. 2018), *https://www.pnc.com/content/dam/pnc-com/pdf/personal/wealth-investments/wealth-articles/cryptocurrency%20series_0818_Intro_PNC.pdf*.
8. *See* CoinMarketCap, *https://coinmarketcap.com/* (last visited Jan. 4, 2019).
9. *See* Kayla Sloan, 7 *Major Companies that Accept Cryptocurrency*, DUE (Jan. 31, 2018, 9:56 AM), *https://due.com/blog/7-companies-accept-cryptocurrency/*.
10. Ether is the currency vehicle for Ethereum. Ethereum is a blockchain technology platform which facilitates peer-to-peer contracts and applications via ether.
11. Diana Olick, *Now You Can Pay Your Rent in Bitcoin*, CNBC (Nov. 30, 2017, 11:21 AM), *https://www.cnbc.com/2017/11/30/now-you-can-pay-your-rent-in-bitcoin.html*.
12. Zoe Biehl, *A Look At The 9 New Stablecoins Entering The Cryptocurrency Market*, Invest In Blockchain (Oct. 9, 2018), *https://www.investinblockchain.com/new-stablecoins-2018/*.
13. *The State of Stablecoins*, Blockchain, *https://www.blockchain.com/ru/static/pdf/StablecoinsReportFinal.pdf* (last visited Dec. 11, 2018).
14. *Id*.
15. Penny Crosman, *N.Y. regulators have approved two cryptocurrencies. Now what?,* American Banker (Sept. 11, 2018), *https://www.americanbanker.com/news/ny-regulators-have-approved-two-cryptocurrencies-now-what*.
16. *See* Cameron Winklevoss, *Gemini Launches the Gemini dollar: U.S. Dollars on the Blockchain*, Gemini (Sept. 10, 2018), *https://medium.com/gemini/gemini-launches-the-gemini-dollar-62787f963fb4*; Paxos Standard, *https://www.paxos.com/standard/* (last visited Dec. 11, 2018).
17. Gemini Trust Company, LLC, *The Gemini Dollar: A Regulated Stable Value Coin,* Gemini, *https://gemini.com/wp-content/themes/gemini/assets/img/dollar/gemini-dollar-whitepaper.pdf* (last visited Dec. 6, 2018).
18. Biehl, *supra* note 12.
19. *Id*.
20. *See OhioCrypto.com,* Office of Ohio Treas., https://ohiocrypto.com/faq (last visited Dec. 11, 2018).
21. Michael C. Tomkies & Lindsay P. Valentine, *Virtual Currency: A Commodity, Property, Security, Or Payment Substitute?*, 37 Banking & Fin. Serv. Rep. 1, 4 (2018).
22. U.S. Patent No. 10,055,715 (filed Sept. 12, 2017) (issued Aug. 21, 2018).
23. Lily Katz, *Square's Merchants are Willing to Accept Bitcoin, Survey Says*, Bloomberg Technology (Mar. 14, 2018, 9:16 AM), *https://www.bloomberg.com/news/articles/2018-03-14/square-s-merchants-are-willing-to-accept-bitcoin-survey-says*.
24. Tomkies, *supra* note 21.
25. *Id*.
26. H.R. 7224, 115th Cong. (2nd Sess. 2018); H.R. 7225, 115th Cong. (2nd Sess. 2018)
27. Tomkies, *supra* note 21.