STARNES DAVIS FLORIE LLP

BANKING & FINANCIAL SERVICES NEWSLETTER

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This periodic newsletter published by the Banking and Financial Services practice group of the litigation firm of Starnes Davis Florie LLP is provided as a summary of some of the recent developments and items of interest in the law and regulatory activity impacting this practice area.

ACCOUNT TRANSACTIONS

RECEIPT OF AN ACCOUNT AGREEMENT DEEMED A REQUISITE TO PROOF OF BREACH OF CONTRACT CLAIM

The Alabama Court of Appeals has again emphasized the need to prove receipt by the account holder of an account agreement and amendments thereto or that he/she agreed to be bound by its terms when relying upon the agreement in a breach of contract action. In this case, American Express sought to enforce its credit card member agreement through summary judgment without the requisite proof of receipt or an agreement by the cardholder to be bound by its terms. In *Wells Fargo BKNA v. Chapman*, 90 So. 2d 774 (Ala. Civ. App. 2012) the Alabama court previously expressed the need for proof of notification of amendments to an account agreement before entitlement to enforcement of its terms.

Thomas v. American Express Bank, FSB, 2013 WL 2120117 (Aug. 2, 2013).

WHETHER A SECURITY PROCEDURE IS REASONABLE AND WHETHER BANK ACTED IN GOOD FAITH DETERMINED CASE-BY-CASE (PLUS BEWARE THE EFTA!)

In our Spring 2013 newsletter, we discussed the Choice Escrow case, in which the U.S. District Court in Missouri found that a bank was not liable for unauthorized wire transfers because (1) it had established a commercially reasonable security procedure in accordance with Article 4A of the UCC; (2) the customer, an LLC, elected to decline the procedure and waived it in writing; and (3) the bank acted in good faith in processing the wire transfer request.

It should be obvious that security procedures can only be deemed reasonable if they are followed. It is also critical to review agreements applicable to accounts periodically—whether corporate or individual—to ensure that they are updated as may be necessary and that any bank personnel who may be involved in administering those accounts are informed of customers' specific instructions regarding the permissibility of certain kinds of transactions from their accounts *and* any additional security requirements specified by a customer as to any account. Single-factor (a password) or two-factor (a password plus something else—for example, a security key) verification can only do so much. Diligence is also necessary. Allowing wire transfers from accounts in contravention of the bank's own policies and procedures or the customer's express, written instructions cannot be defended as "commercially reasonable."

Although fraudulent wire transfer cases involving corporate or other business (that is, non-consumer) accounts have generally tended to be resolved in favor of banks deemed to have offered commercially reasonable security and to have acted in good faith—Choice Escrow, as already noted, is one example—courts are looking ever more closely at the particular facts presented in each case.

Last year, a federal appeals court, in Patco Construction Company, Inc. v. People's United [formerly Ocean] Bank, 684 F. 3d 197 (1st Cir. 2012), reversed the district court's summary judgment in favor of the bank and determined, on the facts presented, that the bank's security procedures were "collectively" *not* commercially reasonable. [This result was, therefore, more akin to the decision reached by the federal district court in Michigan in Experi-Metal v. Comerica Bank, 2011 WL 2433383 (E.D. Mich. June 13, 2011), where the bank was deemed not to have acted in good faith when it accepted 97 wire transfer payment orders totaling more than $1.9 million over several hours from the corporate customer's account.]

An additional dynamic is added when a "consumer" account is impacted—making the Electronic Funds Transfer Act ("EFTA") applicable. The "primary objective" of the EFTA, 15 U.S.C. § 1693, *et seq*., "is the provision of individual consumer rights." See U.S.C. § 1693(b). Under the EFTA, "the term 'unauthorized electronic funds transfer' means an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such a transfer and from which the consumer receives no benefit...." 15 U.S.C. § 1693a(12). A "consumer," under § 1693a(6), is "a natural person." The accounts covered are, per § 1693a(2), "demand deposit, savings deposit, or other asset account[s]...established primarily for person, family, or household purposes," but not "trust accounts held by financial institutions pursuant to a bona find trust agreement."

If a bank debits a consumer's account without written authorization to do so and/or contrary to written instructions and limitations on those accounts, the bank is likely to be deemed in violation of the EFTA unless, where the bank receives timely notification from the consumer requesting resolution of the unauthorized transfer, it promptly takes all of the legally required steps toward resolution. If the bank fails to do so, it risks being deemed to have acted in bad faith, which exposes the bank not only to liability for compensatory damages actually sustained by the consumer—including the amount of the unauthorized transfers, service charges, and lost interest on those accounts—but also to treble damages in accordance with 15 U.S.C. § 1693f., as well as attorneys' fees determined by the court.

All relevant bank personnel need to be thoroughly trained to address any notification regarding unauthorized transfers in an effective and legally compliant manner.

RECOVERY – FORECLOSURE

Ejectment

Alabama's Court of Civil Appeals previously issued several opinions that muddied the water for plaintiffs suing to eject foreclosed borrowers. These decisions focused on whether a foreclosing entity possessed standing at the time foreclosure proceedings were initiated in order to maintain an action for ejectment of the borrower from the foreclosed property. The Supreme Court of Alabama reviewed these decisions and issued a series of opinions to settle the issue.

First, the Alabama court clarified what is "standing" and what is "failure to state a claim." Finding the lines separating the two had been blurred, the court explained that what passed for a "standing" defense should have been called a "failure-to-prove-the-elements-of-a-claim" defense. The court expressly overruled prior decisions requiring the ejectment plaintiff to prove all the elements of its claim in order to establish standing to maintain an ejectment action.

Ex parte BAC Home Loans Servicing, LP, Case No. 1110373 (Ala. Sept. 13, 2013) (overruling *Sturdivant v. BAC Home Loans Servicing, LP*, -- So. 3d -- (Ala. Civ. App. 2011) and *Cadle Co. v. Shabani*, 950 So. 2d 277 (Ala. 2006)).

In the other two cases, the Alabama court reversed the Court of Civil Appeals in its reliance on a parties' status at the time the foreclosure was initiated. The court analyzed the applicable Alabama Code sections to focus on the timing issues presented in many cases over the assignments of mortgage and power-of-sale rights. As contemplated by the Alabama Code and recognized by the court, the date of the execution of the power of sale—the delivery of the foreclosure deed—is the only date that matters; not the initiation of the foreclosure process. Thus, a party entitled to the debt secured by the mortgage at the time of the execution of the power of sale has standing to execute and deliver the foreclosure deed and maintain an action for ejectment.

Ex parte GMAC Mortgage, LLC, Case No. 1110547 (Ala. Sept. 13, 2013); *Harris, et al. v. Deutsche Bank National Trust Company*, Case No. 1110054 (Ala. Sept. 13, 2013).

THE DODD-FRANK ACT & CONSUMER FINANCIAL PROTECTION BUREAU

In the first quarter of 2013, the Consumer Financial Protection Bureau (CFPB) issued final regulations pursuant to the Dodd-Frank Act impacting residential mortgage lending. Among these final rules, about which we have previously reported, were the Ability to Pay Rule, Mortgage Servicing Rules, and Loan Originator Compensation Rules. Since that issuance, the CFPB has made some changes to these rules through a series of amendments in response to lender concerns.

Ability to Repay

First, in May 2013, the CFPB amended Regulation Z regarding the Ability to Repay Rule by providing certain exemptions for certain creditors and loans. It also provided an additional definition of a "qualified mortgage" for certain loans made and held by small creditors and a temporary definition of a "qualified mortgage" for balloon loans. The changes also modified the requirements for the inclusion of loan origination compensation in the points and fees calculation.

In July 2013, additional amendments to Regulation Z and Regulation X were issued. Under the finalized rules, a borrower must have a debt-to-income ratio of less than 43% for the loan to be considered a "Qualified Mortgage" in addition to other requirements. The CFPB clarified that the DTI ratio can include other incomes from the borrower, including a business credit report if self-employed and non-employment related income, such as a trust or rental property.

The clarification also stated that a creditor with a GSE-approved loan would not have to meet the other procedural and technical requirements, if completely unrelated to the consumer's ability to repay.

In September 2013, additional amendments were issued. The CFPB gave more flexibility to community banks by allowing the smaller lenders that did not fall under the exemptions for rural and underserved counties to be able to offer higher-priced mortgages under certain restrictions. The CFPB also committed to conduct a study of its definition of "rural" or "underserved areas" for the next two years.

12 CFR §§ 1024, 1026.

Despite all of these changes, the CFPB has been unwilling to extend its January 2014 implementation deadline for the mortgage loan regulations.

While the CFPB has held fast to its "Qualified Mortgage" requirements, the Department of Housing and Urban Development ("HUD") has proposed a "QM" definition which differs from the CFPB rule. The HUD proposal drops the required 43% debt to income ratio and removes the cost of mortgage premiums from its interest rate pricing cap. Thus, under the HUD proposal, a QM FHA loan cannot cost more than the average prime rate plus 115 basis points. How these differences might further squeeze certain lending remains to be seen.

Also, the six agencies involved in determining the mandates for the QRM securitization rule have recently proposed to link the QRM definition to the QM definition set by the CFPB and abandon the criticized specific down payment requirement. It is expected that there will be substantial comments submitted in response to this proposal which seems to empower the CFPB further in the area of risk retention upon securitization.

In response to concerns expressed by lenders that limiting mortgage lending to predominately "Qualified Mortgages" could lead to fair lending violations, six financial regulators, including the Federal Reserve Board, CFPB, FDIC, OCC and the National Credit Union Administration, recently issued a joint statement regarding this issue. The statement indicated that the "QM" rule and the ECOA are "compatible" and that they do not anticipate a creditor's decision to offer only Qualified Mortgages would, absent other factors, increase a creditor's fair lending risk. While the statement was clearly not a safe harbor from potential fair lending violations, it did provide some comfort that the "QM" rule would not, in and of itself, increase this risk.

Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule, October 22, 2013.

SERVICING RULES

The CFPB also issued amendments and guidance regarding its mortgage servicing rules in May, September and October 2013. The amendment changes included the following:

(1) Established that servicers will be allowed to send early delinquency notices required under state law to borrowers that may provide information regarding legal aide, counseling or other re sources;

(2) Require servicers to notify borrowers of any needed information and provide time for pro viding such information relating to a borrower's lost mitigation application; and

(3) Allowing a servicer to provide a six month forbearance to a borrower who is suffering a short term hardship and needs temporary relief due to a loan delinquency.

The CFPB also clarified the mortgage loan servicing rules by concluding that it would exempt loans serviced by small servicers on a charitable basis. It also stated that the RESPA rule would not preempt state regulation of mortgage servicing.

12 CFR §§ 1024 & 1026.

The guidance bulletin issued by the CFPB in October 2013 addressed the need for servicers to maintain communication with any successor in interest of a deceased borrower with regard to the property securing the loan, communication with borrowers under the early intervention rule and the obligation to provide certain notices to borrowers who have elected to bar debt collector communications under the Fair Debt Collections Practices Act (FDCPA).

CFPB Bulletin 2013-12, October 15, 2013.

KICKBACKS IN MORTGAGE LENDING

In May 2013, the CFPB instituted an action against a Texas homebuilder for violation of RESPA when it established joint ventures with a state bank and a non-depository which were alleged to be shams created to allow kickbacks to the homebuilder through payments by two mortgage lenders under a service agreement. This claim was settled through a consent order.

In re Paul Taylor Homes Limited, et al., No. 2013-CFPB-0001 (May 17, 2013).

Also in April 2013, the CFPB announced settlements of $15 million in penalties with four national mortgage insurers alleging kickbacks with various lenders through captive reinsurance arrangements.

CFPB v. Genworth Mortgage Ins. Corp., Case No. 1:13-cv-21183 (S.D. Fla. 2013)*; CFPB v. Mortgage Guaranty Ins. Corp.*, Case No.: 1:13-cv-21187 (S.D. Fla. 2013); *CFPB v. Radian Guaranty Inc.*, Case No. 1:13-cv-21188 (S.D. Fla. 2013); *CFPB v. United Guaranty Corp*., Case No. 1:13-cv-2189 (S.D. Fla. 2013).

The CFPB has also recently brought an action against a Kentucky law firm for receiving illegal kickbacks in real estate settlements through the formation of a network of shell companies. The action includes claims against the three individual principals for violations of RESPA due to their receipt of substantial fees through this referral network.

CFPB v. Borders & Borders PLC, et al., Case No. 3:13-cv-01047-JGH (W.D. Ky. 2013).

LOAN OFFICER COMPENSATION

The CFPB filed an action in U. S. District Court in Salt Lake City, Utah against Castle & Cooke Mortgage for allegedly giving bonuses to loan officers who allegedly steered customers into mortgages with higher interest rates. Such bonuses were provided without a written policy explaining the method of calculation or what portion was attributable to specific loans. The action, which is still pending, is based upon the Federal Reserve Loan Officer Compensation Rule which bans compensation based on a loan's terms, such as its interest rates. It is the first action brought against a mortgage originator for failing to follow the new Reg Z requirements for Loan Officer Compensation. It also targeted two of the company's top executives seeking personal liability as well for these practices.

CFPB v. Castle & Cooke Mortgage, et al., Case No.: 2:13-cv-00684 (D. Utah 2013).

ABUSIVE PRACTICES

The CFPB has filed a number of actions against entities for allegedly charging illegal upfront fees for debt relief services. One of those actions was filed in May 2013 against a Florida debt relief company regarding its imposition of such fees for debt relief services which were rarely performed. The practice involved the charging of over $500,000 in fees to hundreds of consumers. This action, which has been settled by a consent order, was one of the first actions by the CFPB to apply the "abusive" acts or practices prohibition of the Dodd-Frank law. The action also addressed prohibited sales calls and telemarketing under the FTC's Telemarketing Sales Rule. 16 C.F.R. § 310.4.

CFPB v. American Debt Solutions, Inc., et al., Case No. 1:13-cv-21909 (S.D. Fla. 2013).

AUTO FINANCING

Even though the CFPB does not regulate auto dealers under the Dodd-Frank Act, the Bureau has extended its authority over indirect auto financing companies under the Equal Credit Opportunity Act ("ECOA") when it has alleged that the practice of the financing companies in purchasing retail contracts from dealers at a buy rate and allowing the dealer to mark-up that rate as a reserve or participation compensation was in violation of the ECOA. The Guidance Bulletin issued by the CFPB in March 2013 highlighted the practice as possibly resulting in the violation of the ECOA. In connection with that published guidance, the CFPB has also issued demands for data relating to these practices and the sale of optional extended warranties, insurance and other add-on products.

DEBIT CARD FEES – DURBIN AMENDMENT

An action was brought by retailer groups to attack the regulations implemented by the Federal Reserve to establish a 24 cent cap on debit card transactions under the Dodd-Frank law. On July 31, 2013, U. S. District Judge Richard Leon issued a 58-page ruling that the Federal Reserve had disregarded Congress's intent in establishing such a high cap. Judge Leon also agreed with the retailer's attack on the Fed's regulation of exclusivity agreements between banks and payment networks in connection with the routing of such transactions, concluding that it did not create competition among the bankcard networks.

Specifically, the D.C. court concluded that the Federal Reserve had erroneously considered costs which were not associated with an individual transaction in establishing the interchange transaction fee standard. While this regulation exempts banks with consolidated assets of less then $10 billion, it has been contended that the ruling will also impact community banks, resulting in a likely increase in bank fees for consumer checking accounts. Some have predicted that exempt small banks would receive the same lower interchange fees, but that has not yet occurred. In fact, some believe the merchant's choice of networks will result in a disadvantage to small lenders.

The Federal Reserve has appealed this controversial ruling to the U. S. Court of Appeals for the D.C. Circuit.

NACS, et al. v. Board of Governors of Federal Reserve, 11-cv-02075 (U.S. Dist. Ct. DC 2013).

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