Financial Services 2017 Year-End Report

BakerHostetler

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Introduction

Welcome to the 2017 Year-End Report from our financial services industry team. We are pleased to share our analysis of some of the key developments in the financial services industry in 2017 and our expectations for 2018. Please contact any of the team members listed at the end of this report if you have questions or would like additional information on these or other issues as they unfold in the coming months.

The significant developments from the past year we focus on in this report include:

- Continued uncertainty around the future of the Consumer Financial Protection Bureau (CFPB) in the wake of continued litigation over the constitutionality of the CFPB's single-director structure and Acting Director Mick Mulvaney's different approach to regulation.
- The future of the "Payday Lending Rule" the CFPB promulgated in October 2017 in the final days of former Director Richard Cordray's leadership, which will be reconsidered by the CFPB in 2018.
- The use by Congress of the Congressional Review Act to disapprove the CFPB's Arbitration Rule.
- Trends in commercial and residential lending in the United States, including the rise in nontraditional financing vehicles for development projects.
- The financial industry's move away from the London Interbank Offered Rate (LIBOR) as a benchmark interest rate.
- How the CFPB's September 2017 final rule modifying the Home Mortgage Disclosure Act (HMDA) disclosure rule will affect mortgage lenders.
- Trends in Chapter 11 bankruptcy filings in the industry, which saw steady growth in retail and energy filings in the wake of increasing competition and declining margins.

Perhaps the most significant trend we have seen is the rise of transformative blockchain technologies and digital currencies. We have created a Blockchain Technologies and Digital Currencies industry team, headed by partner Laura Jehl and Chief Information Officer Bob Craig, who are thought leaders in the legal and business issues arising from blockchain technologies. The team helps clients navigate the rapidly evolving regulatory environment associated with initial coin offerings (ICOs) and token generating events (TGEs), including corporate and securities matters, tax issues, and other regulatory hurdles. The Blockchain Technologies and Digital Currencies industry team works closely with the Financial Services team to address the opportunities and challenges associated with these exciting new technologies.

We hope that you use our analysis and forecasts for the rest of 2018 to help you navigate what is likely to be a year of unprecedented change.

For updates throughout the year, please visit the Financial Services Blog and the blogs sponsored by other practice teams, including the Class Action Lawsuit Defense and the Data Privacy Monitor blogs.

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Litigation

Litigation

Industry Developments

Henson v. Santander Consumer USA Inc., No. --- U.S. ---, 137 S.Ct. 1718 (2017)

In 2017, consumers initiated nearly 10,000 lawsuits alleging violations of the Fair Debt Collection Practices Act (FDCPA). *See* WebRecon LLC*, Stats for November 2017: Bizarro Stats*, www.webrecon.com (2017) (reporting that consumers initiated 9,072 FDCPA lawsuits through Nov. 30, 2017). The prevalence of FDCPA lawsuits may decline, however, following the U.S. Supreme Court's decision in *Henson v. Santander Consumer USA Inc.*

In June, the Supreme Court decided the issue of who qualifies as a "debt collector" under the FDCPA. In his first authored decision as a member of the high court, Associate Justice Neil Gorsuch wrote a unanimous opinion holding that an entity may collect debts that it purchased on its own behalf without automatically triggering the FDCPA.

In reaching this decision, the Court looked to the FDCPA's definition of the term "debt collector." Under the statute, a debt collector is anyone who "regularly collects … or attempts to collect … debts owed or due … another." 15 U.S.C. § 1692a(6). Respondent Santander Consumer USA (Santander) purchased debts in default from an automobile loan originator and then sought to collect on those recently acquired debts. The dispositive question in the case was whether Santander, as the new owner of those debts, qualified as a debt collector.

Focusing on the statutory language, the Court reasoned that the FDCPA targeted third-party collection agents working for a debt owner, not a debt owner seeking to collect debts for itself. The Court elaborated that the FDCPA did not apply to Santander because the statutory definition made no distinction between various classes of debt owners, i.e., loan originators as opposed to debt purchasers. The Court also rejected the petitioners' public policy arguments, reasoning that those arguments essentially asked the Court to rewrite a constitutionally valid statute.

En Banc D.C. Circuit Reviews PHH Decision

In February 2017, the D.C. Circuit granted the CFPB's motion for a rehearing en banc and vacated the October 2016 decision by a three-judge panel of the court that ruled, among other things, that the CFPB's structure was unconstitutional to the extent that its single director was removable only for cause. On May 24, 2017, the D.C. Circuit heard oral arguments from PHH Corp., the Department of Justice and the CFPB on the central issue of whether the CFPB's structure violates the U.S. Constitution. During oral argument, minimal time was spent examining the Real Estate Settlement Procedures Act (RESPA) and statute of limitation rulings from the three-judge panel.

The D.C. Circuit issued a decision on Jan. 31, 2018, upholding the CFPB's single-director structure. The next steps in the litigation are uncertain, although further appeal to the U.S. Supreme Court is anticipated. We also mention two noteworthy developments around the time of the en banc decision. First, in November 2017, Director Richard Cordray stepped down as the head of the CFPB. Second, in January 2018, the Supreme Court granted certiorari in *Lucia v. SEC* – a case cited by the D.C. Circuit in February when it agreed to rehear the PHH matter – to determine whether the Securities and Exchange Commission's (SEC's) administrative law judges (ALJs) serve in violation of the Appointments Clause of the U.S. Constitution. The *Lucia* case is potentially significant given that prior to the case reaching the D.C. Circuit, the original ruling against PHH was made by an ALJ from the SEC to whom the CFPB assigned the matter.

Litigation

CFPB Arbitration Agreement Rule

On May 24, 2016, the CFPB published its proposed rule on arbitration agreements in the Federal Register.[1] While the rule's notice-and-comment period ended on Aug. 22, 2016, the CFPB did not publish its final rule until July 19, 2017.[2] Under the rule, covered providers of certain consumer financial products and services were prohibited from utilizing predispute arbitration agreements to prevent consumers from "filing or participating in a class action with respect to the covered consumer financial product or service."[3] Covered providers also were required to insert language stating such a limitation in their arbitration agreements.[4] In addition, covered providers that participated in arbitral proceedings pursuant to a predispute arbitration agreement would be required to furnish particular information regarding those arbitrations.[5] The CFPB championed the rule as providing consumers with sufficient opportunities to seek relief from providers' legal violations as well as to provide greater transparency into the arbitration of consumer disputes.[6] The rule became effective on Sept. 18, 2017, but would have applied only to predispute arbitration agreements entered into after March 19, 2018.[7]

Unhappy with the implications of the arbitration agreements rule, the Republican-dominated House of Representatives utilized the Congressional Review Act (5 U.S.C. 801 et seq.) to easily pass House Joint Resolution 111 (231190) on July 25, 2017, disapproving the rule.[8] The Senate followed suit by passing the resolution on Oct. 24, 2017, but not without the help of Vice President Mike Pence's deciding vote.[9] Congress presented the joint resolution to President Donald Trump on Oct. 25, 2017, and it was signed into law on Nov. 1, 2017.[10] The CFPB arbitration rule was nullified, and then-CFPB Director Cordray removed the rule from the Code of Federal Regulations on Nov. 22, 2017.[11]

Second Circuit Issues Intriguing TCPA Revocation-of-Consent Decision

Cases brought under the Telephone Consumer Protection Act (TCPA) continue to be a source of litigation for financial institutions. A notable decision issued in the Second Circuit involves the issue of consent. In *Reyes v. Lincoln Automotive Financial Services*, the Second Circuit addressed whether the TCPA permits a party to a legally binding contract to unilaterally revoke bargained-for consent to be contacted by telephone.[12] In this case, the consumer financed the lease of his vehicle and in doing so provided his cellphone number in the application.[13] When the consumer stopped making payments, Lincoln attempted to contact him through calls to his cellphone using

1 CFPB Arbitration Agreements, 81 Fed. Reg. 32829 (proposed May 24, 2017) (to be codified at 12 C.F.R. pt. 1040).

2 CFPB Arbitration Agreements, 82 Fed. Reg. 33210 (July 19, 2017) (to be codified at 12 C.F.R. pt. 1040).

3 *Id.*

4 *Id.*

5 *Id.*

6 CFPB Arbitration Agreements, 81 Fed. Reg. 32830 (proposed May 24, 2017) (to be codified at 12 C.F.R. pt. 1040).

7 CFPB Arbitration Agreements, 12 C.F.R. § 1040 (2017).

8 H.R.J. Res. 111, 115th Cong. (2017) (enacted).

9 H.R.J. Res. 111, 115th Cong., 163 Cong. Rec. S6760 (daily ed. Oct. 24, 2017) (enacted).

10 Act of Nov. 1, 2017, Pub. L. No. 115-74, 131 Stat. 1243.

11 CFPB Arbitration Agreements, 82 Fed. Reg. 55500 (Nov. 22, 2017) (to be codified at 12 C.F.R. pt. 1040).

12 *Reyes v. Lincoln Automotive Financial Services*, 861 F.3d 51, 53 (2d. Circ. 2017).

13 *Id.*

an automated dialer system.[14] The consumer attempted to stop the calls by issuing a written letter to Lincoln in which he attempted to revoke consent.[15] When the calls continued, the consumer initiated an action alleging violations of the TCPA.[16]

The Second Circuit's opinion turned on the interpretation of "consent" as an issue of tort or contract law.[17] Determining that the TCPA is silent on the issue of whether a party that has consented can subsequently revoke consent, the court looked to the Federal Communications Commission's 2015 omnibus ruling, which it read as permitting revocation of consent when it was not provided for any consideration.[18] Ultimately, the Second Circuit distinguished the fact pattern before it by finding that the consumer's consent was provided as an express provision of the lease and therefore consent could not be revoked.[19]

Notably, *Reyes* does not appear to be operating as a backstop to TCPA claims. Some courts have rejected the Second Circuit's reasoning, and it is not certain that other courts will follow the Second Circuit's lead.

Representative Matters

FCRA Class Action Dismissed Pending Arbitration

In August, we successfully used the Federal Arbitration Act to dismiss a putative Fair Credit Reporting Act (FCRA) class action brought against Fifth Third Bank (Fifth Third) in the Southern District of Ohio.

In *Jenkins v. Fifth Third*, plaintiff Randy Jenkins alleged that Fifth Third violated the FCRA by allegedly submitting credit-reporting inquiries after prior bankruptcy proceedings discharged his credit card debt. When Jenkins opened a credit card account with Fifth Third, however, he agreed to arbitrate any claim, dispute or controversy arising from his account. Despite this mandatory arbitration provision, Jenkins filed a complaint against Fifth Third in the Southern District of Ohio.

Our team sought a dismissal, arguing that the Federal Arbitration Act required the district court to compel arbitration of Jenkins' individual claim. In rejoinder, Jenkins argued that the arbitration provision no longer applied to him because the bankruptcy proceeding discharged his credit card debt and all associated obligations. We successfully convinced the district court that Jenkins' bankruptcy had no effect on the arbitration provision because the FCRA claim was unrelated to the debt discharged in that proceeding.

Jenkins also argued that the arbitration agreement was unenforceable because arbitrating his individual FCRA claim was cost-prohibitive and effectively prevented the putative class's vindication of FCRA rights. But we convinced the court that Jenkins' argument was too speculative in light of the unambiguous arbitration agreement and the strong federal policy favoring arbitration. As a result, the court dismissed the complaint, and Fifth Third avoided a putative FCRA class action.

14 *Id.* at 54.
15 *Id.*
16 *Id.*
17 *Id.* at 56.
18 *Id.* at 56-57.
19 *Id.* at 58.

Litigation

Defended, on Appeal, Dismissal of Putative Class Action Challenging the MERS System

We represented three of Ohio's largest banks in the defense of a putative class action brought by county prosecutors challenging the use of the MERS System and seeking to require lenders to publicly record all residential mortgage assignments in Ohio. After securing the dismissal of the plaintiffs' second amended complaint, we defended the banks on appeal, filing a merit brief in support of the trial court's order dismissing the complaint. The court of appeals affirmed the dismissal of the action.

Fraudulent Inducement Claim in Commercial Lending Deal Dismissed

A large regional bank turned to us when a prospective borrower sued, alleging fraud and breach of a commercial lending commitment after the U.S. Small Business Administration (SBA) failed to approve a loan guarantee that was required in order for the loan to close. The plaintiff alleged that the bank misled it into applying for the loan by making certain statements or omissions concerning the likelihood of the SBA's approval of the loan guarantee. After the bank moved for summary judgment, the plaintiff changed theories, arguing that the bank failed to disclose certain details concerning the SBA's review of loan applications. On the eve of trial, the court granted our motion for summary judgment in its entirety.

Emerging Issues and Trends

The past year saw a significant decrease in consumer-initiated litigation. Claims brought pursuant to the TCPA dropped by 9.3 percent.[20] That TCPA claims dropped by almost 10 percent is particularly surprising, as claims dramatically rose between 2010 and 2016.[21]

For the second year in a row, FDCPA claims dropped. In 2017, FDCPA-related claims dropped 5.8 percent from the previous year.[22] We anticipate that FDCPA cases will continue to drop in the wake of *Santander*.

Conversely, FCRA claims rose by 9.9 percent over 2016.[23]

Notably, 23.6 percent of the FDCPA claims brought in 2017 were brought as class actions. Additionally, 22.1 percent of the TCPA claims were class actions.

FCRA claims showed the smallest percentage of class actions, 6.0 percent, which is not surprising given the specific nature of the claims. Over the next year, we anticipate that FCRA claims will continue to rise only minimally or will hold steady.

Spokeo II

On remand from the U.S. Supreme Court, the Ninth Circuit held in *Spokeo II*[24] that an alleged statutory violation of the procedural requirements of 15 U.S.C. § 16813(b) of the FCRA may be a sufficiently concrete injury for purposes of Article III.

20 WebRecon Stats for December 2017 & Year in Review, available at: https://webrecon.com/webrecon-stats-for-dec-2017-year-in-review/.

21 *Id.*

22 *Id.*

23 *Id.*

24 *Robins v. Spokeo, Inc.*, 867 F.3d 1108 (9th Cir. 2017).

Litigation

In *Spokeo II*, plaintiff Thomas Robins alleged that as a result of violating the FCRA's procedural requirements for the creation and use of consumer reports, Spokeo created and published on its website a consumer report about him containing inaccurate information about his age, marital status, wealth, level of education and profession.[25] Robins alleged that the inaccurate information adversely affected his employment prospects at a time when he was unemployed.[26] After the district court held that Robins lacked Article III standing to sue under the FCRA, the Ninth Circuit reversed in *Spokeo I*.[27] On certiorari, the Supreme Court vacated the Ninth Circuit's opinion, finding that while the appeals court properly considered whether Robins' alleged injury was sufficiently particularized for Article III standing, its concreteness inquiry was lacking.[28]

On remand, Robins argued that "because FCRA exists to protect consumers' concrete interest in credit-reporting accuracy," Spokeo's failure to follow the requisite procedures "to ensure the accuracy of his consumer report … is, alone, enough to establish a concrete injury."[29] Echoing the Supreme Court's opinion, the Ninth Circuit explained that a statutory violation of the FCRA alone does not automatically confer Article III standing; instead, to establish a concrete injury for purposes of Article III, "the plaintiff must allege a statutory violation that caused him to suffer some harm that actually exist[s]," is "real," and is not "abstract" or "merely procedural."[30]

After considering other circuit opinions and recognizing that deference is due to "congressional judgment," the court held that a statutory violation meets the concreteness requirement of Article III where (1) "the statutory provisions at issue were established to protect [a plaintiff's] concrete interests (as opposed to his purely procedural rights)" and (2) "the specific procedural violations alleged[] actually harm, or present a material risk of harm to, such interests."[31] Here, the court had "little difficulty" finding that the FCRA provisions allegedly violated exist to protect consumers' concrete interests, as the "real-world implications of material inaccuracies in [inaccurate consumer] reports seem patent on their face."[32] As to the second prong, the plaintiff's allegations that the inaccuracies in his consumer report "caused actual harm to his employment prospects by misrepresenting facts that would be relevant to employers" was sufficient.[33] Yet, while Robins' alleged injury was sufficiently concrete for purposes of Article III, the court cautioned that not every "trivial or meaningless inaccuracy" in a consumer report will harm consumers' concrete interests in accurate consumer reporting and thus will not confer Article III standing under the FCRA.[34]

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25 *Id.* at 1111.

26 *Id.*

27 *Robins v. Spokeo, Inc.*, 742 F.3d 409 (9th Cir. 2014).

28 *Spokeo, Inc. v. Robins*, 136 S.Ct. 1540 (2016).

29 *Spokeo II*, 867 F.3d 1108, 1112 (2017).

30 *Id.* (quotations omitted).

31 *Id.* at 1112-13.

32 *Id.* at 1114.

33 *Id.* at 1117.

34 *Id.* at 1116.

Lending

Lending

Industry Developments

The eventual replacement of LIBOR as a benchmark rate was a significant development in 2017. The U.K.'s Financial Conduct Authority (FCA) announced in July that banks will no longer be required to submit LIBOR reporting after 2021. As a result, and because LIBOR currently is referenced in trillions of dollars of financial transactions in the United States and worldwide, the search is on for a reliable replacement benchmark. Banks, regulators, borrowers and other market participants are continuing to identify potential benchmarks. For instance, in the U.S., the Federal Reserve created the Alternative Reference Rates Committee (ARRC) to identify alternative benchmark rates to replace LIBOR. In the U.K., regulators and banks have separately established working groups to identify and agree on an appropriate replacement. Financial markets appear to have taken the eventual replacement of LIBOR in stride, in part because of general agreement on the need to replace LIBOR and because the LIBOR reporting requirement will continue for four more years.

It will be important to monitor developments in the replacement of LIBOR and the effect it will have on medium- and long-term loans and a wide variety of other financial transactions.

In the meantime, financial institutions should review the LIBOR provisions in their loan agreements, with an eye toward fallback provisions governing interest rates in the event LIBOR becomes unascertainable. Most well-drafted loan agreements provide a mechanism for replacing LIBOR in such a circumstance. However, in many instances, those mechanisms are designed as short-term LIBOR replacements rather than a way to address the elimination of LIBOR. Lenders should consider amending their customary LIBOR language in new agreements – as well as in connection with amendments to existing agreements – to add the flexibility to adopt a new reference rate in connection with the eventual replacement of LIBOR.

Representative Matters

Variety of Loans and Financing

Represented KeyBank, Fifth Third Bank, PNC Bank and numerous other institutional lenders in a variety of middle-market commercial loans, construction loans, real estate finance and bond financings.

Loan on Loan

Represented Centennial Bank in connection with a $62 million loan on loan to a fund. Collateral for the loan included a mortgage loan encumbering mixed-use property located in the Bushwick section of Brooklyn, New York. The underlying borrower will construct improvements, including commercial space and a multifamily residential building to complement an existing community center on the property.

Repurchase Agreement

Represented Centennial Bank in connection with a $20 million repurchase agreement for a $34.67 million commercial mortgage loan encumbering an office building in Miami.

Lending

Emerging Issues and Trends

2017 saw continued growth in commercial real estate. While many deal-makers expect this growth to continue in 2018, there are a few factors that may hinder growth both in the overall market and in certain individual asset classes.

Overall commercial real estate transaction volume decreased about 15 percent from August 2016 through August 2017. Historically, a decrease in volume is sometimes a precursor of an overall turn in the market.

As for individual asset classes, residential and retail continue to see change. In many metropolitan areas, there are signs of an overabundance of luxury housing. A possible area of housing growth is middle-market, relatively affordable housing for young professionals as well as seniors. Traditional retail centers are likely to continue to be pressured by the growth of online retail. Still, growth opportunities exist for properties that can pivot toward experiential or social-type retail, such as restaurants, gyms and other opportunities where social interaction is important to the customer experience.

Look for the increase in activity of nontraditional lenders to continue through 2018. Overall increased selectivity as well as Basel III's high-volatility commercial real estate rule have caused banks to pull back on certain loans, especially construction financing. As a result, mezzanine lenders, hard-money lenders and funds have filled the gap and should continue to do so. A drawback to this trend is that nontraditional lenders charge a premium interest rate, which limits deals with thin profit margins.

Regulatory, Compliance and Licensing

Regulatory, Compliance and Licensing

Industry Developments

The Financial Choice Act

In summer 2017, the U.S. House of Representatives passed the Financial Creating Hope and Opportunity for Investors, Consumers, and Entrepreneurs Act of 2017 (H.R. 10) (Financial Choice Act).[35]

The Financial Choice Act – introduced by House Financial Services Committee Chairman Jeb Hensarling – makes several significant changes to the regulatory scheme set forth by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). In passing the Financial Choice Act, the House asserted that these changes are intended "to create hope and opportunity for investors, consumers, and entrepreneurs by ending bailouts and Too Big to Fail, holding Washington and Wall Street accountable, eliminating red tape to increase access to capital and credit, and repealing the provisions of the Dodd-Frank Act that make America less prosperous, less stable, and less free …."[36]

Generally, the Financial Choice Act makes significant changes to the regulatory reforms and related agencies and practices set forth by Dodd-Frank. In particular – and among its many other provisions – the Financial Choice Act:

- Restructures the CFPB.
- Eliminates the Financial Stability Oversight Council's ability to designate nonbank financial companies as systemically important financial institutions.
- Removes Dodd-Frank's Orderly Liquidation Authority (the way the government and regulators deal with failing banks) and transfers that authority into the bankruptcy code.
- Puts bank "stress tests" on a biannual schedule.[37]

Banking organizations can further exempt themselves from regulatory requirements by maintaining certain leverage ratios. This "off-ramp" provision means that qualifying banks will be exempt from certain rules or limitations related to liquidity standards.[38]

Moreover, the Financial Choice Act extends beyond changes to Dodd-Frank. Some other notable provisions include changes related to corporate governance, fiduciary relationships, SEC reporting and disclosure requirements, administrative law processes and agency rule-making, standards for judicial review, and heightened enforcement programs.

If it becomes law, the Financial Choice Act will implement substantial changes to the financial regulatory environment. But for now, the Financial Choice Act remains in the Senate, where it faces an uncertain future.

35 *H.R. 10 – Financial CHOICE Act of 2017*, Congress.Gov, https://www.congress.gov/bill/115th-congress/house-bill/10.

36 H.R. 10, 115th Cong. (2017).

37 *Id.*; Rachel Witkowski, Andrew Ackerman, *What's in the Financial Choice Act*, WALL ST. J. (June 8, 2017, 4:50 PM), https://www.wsj.com/articles/whats-in-the-financial-choice-act-1496955001; Bob Bryan, *Overview of Financial Choice Act*, BUSINESS INSIDER (May 3, 2017, 2:05 PM), http://www.businessinsider.com/financial-choice-act-wall-street-regulation-bill-2017-5; Rodgin Cohen, Andrew Gerlach & Samuel Woodall, *A Closer Look At Financial CHOICE Act 2.0*, Law360.com (April 24, 2017, 6:30 PM), https://www.law360.com/articles/916317/a-closer-look-at-financial-choice-act-2-0.

38 Executive Summary of the Financial Choice Act, https://financialservices.house.gov/uploadedfiles/financial_choice_act_executive_summary_final.pdf.

Regulatory, Compliance and Licensing

Home Mortgage Disclosure Act

In October 2015, the CFPB issued what was expected to be the final HMDA rule. The new rule both changed the coverage and significantly expanded the data points to be collected and reported by financial institutions. In April 2017, the CFPB issued a modified HMDA rule to clear up and correct issues identified in the 2015 rule.

Lenders are amassing the new data as required to collect, record and report on loans with action taken on or after Jan. 1, 2018. For 2018, 25 new data fields have been added, bringing the total number of required data fields to 48. This includes borrower age and credit score, loan to value, and points and fees. For the first time, lenders will be required to share the same data on approved but not accepted preapproval requests. The expanded data will be collected and reported to the CFPB by March 1, 2019.

The costs to implement new HMDA collection, validation and reporting will impact all lenders for years. Lenders will need to validate the data and evaluate the impact of additional data on fair lending efforts across protected classes for fair lending concerns. HMDA previously has been a tool used in fair lending claims. The additional data will allow greater analysis of lending practices. All lenders will need to review and evaluate data to monitor potential claims and litigation.

In late December 2017, the CFPB announced that it will not assess penalties on lenders when good faith efforts are made to collect, record and report 2018 data in early 2019. The CFPB also stated that covered institutions would not be required to resubmit HMDA data unless errors are material. Our team will stay engaged in the rule review process. The CFPB agreed to open the rule-making process in order to assess and reconsider the institutional coverage and discretionary data points that were added to the rule. All lenders will want to stay informed as the process evolves.

Small-Dollar Rule

The CFPB created the Small-Dollar Rule to establish consumer protections for certain consumer credit products.[39] The rule applies to three types of loans – short-term loans, longer-term loans with balloon payments, and covered longer-term loans.[40] According to the rule, short-term loans have terms of 45 days or less.[41] Longer-term balloon-payment loans require repayment of the entire balance of a single advance more than 45 days after consummation in either a single payment or through at least one payment that is more than twice as large as any other payment.[42] Longer-term balloon payment loans also include those that are structured as loans with multiple advances where paying the required minimum payments may not fully amortize the outstanding balance by a specified date, and the amount of the final payment to repay the outstanding balance could be more than twice the amount of other minimum payments.[43] Covered longer-term loans are loans with a cost of credit that exceeds a 36 percent annual percentage rate and a form of leveraged payment mechanism that gives the lender the right to withdraw payments from the consumer's account.[44]

39 Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54472 (Nov. 17, 2017) (to be codified at 12 C.F.R. § 1041).

40 *Id.*

41 *Id.*

42 *Id.* at 54472, 54527.

43 *Id.*

44 *Id.* at 54472, 54498.

Regulatory, Compliance and Licensing

The rule, however, excludes or exempts certain categories of loans from its requirements.[45] Loans extended to purchase a car, home mortgages secured by real property and credit cards are examples of loans that have been excluded or exempted.[46] Notably, to avoid unfair and abusive practices, lenders must reasonably determine whether consumers have the ability to repay a loan according to the loan terms.[47] And as explained further in the rule, lenders are subject to additional disclosure, payment withdrawal, and data and record retention requirements.

Representative Matters

Due Diligence (M&A)

Provided due diligence support to ECN Capital Corp. on $300 million acquisition of Service Finance Co. Conducted nationwide surveys of state consumer lending laws and provided counsel with regard to licensing, fees and other related issues.

Represented ECN Capital Corp. on $40 million acquisition of Triad Financial Services Inc., which finances manufactured homes. Led 50-state change-of-control filing effort with regard to all change-of-control filings, and worked with regulators to expeditiously obtain the necessary approvals needed, resulting in a favorable outcome for the client.

Regulatory and Compliance

Counseled a federally chartered bank in connection with an online marketplace lending and white label form solution concerning automobile refinancing as well as a new-to-market student loan refinancing product.

Licensing

Represented Ohio Mortgage Bankers Association in finalizing House Bill 199, which created the Ohio Residential Mortgage Lending Act. The law amends and renames the current Ohio Mortgage Broker Act, OMBA – O.R.C. 1322, and the Ohio Mortgage Loan Act, OMLA – O.R.C. 1321. The new law eliminates the need to hold dual mortgage licenses and limits the application of the current Ohio Mortgage Loan Act to unsecured loans and loans secured by other than residential real estate.

Emerging Issues and Trends

Change is coming for lenders using the Nationwide Multistate Licensing System (NMLS) in 2018. The NMLS system is in the final stretch of a multiyear overhaul. Recently, the Conference of State Bank Supervisors (CSBS) has incorporated the remodel of the NMLS into a larger effort to transform licensing and supervision, including of fintech firms. State regulators have used the NMLS to license nonbank lenders since 2010. The system has expanded to include money transmitters, consumer lenders and more. The NMLS also is used to register mortgage lenders working for state and federal banks. The extensive redesign process began in late 2014 as NMLS 2.0, but the new vision is bold.

45 *Id.* at 54472, 54473.

46 *Id.*

47 *Id.*

Regulatory, Compliance and Licensing

Vision 2020 was unveiled in May 2017 and incorporated the final stages of the NMLS 2.0 development into a larger and grander vision for state regulation. The project has focused on being more user-driven and utilizes data analytics to improve supervision and licensing. Vision 2020 incorporates fintech companies that recently have been the center of discussion regarding a proposed national charter. CSBS is certainly positioning its strengths and working to fight that effort.

The final NMLS development timeline was released in August 2017 as part of Vision 2020 to provide an overview of how NMLS 2.0 will integrate into a cohesive system of financial services supervision. NMLS 2.0 is being developed as an intuitive system to be user-driven and more responsive and to better leverage data whenever possible. Once it is rebuilt on a modern platform, it should provide states the ability to expedite processing for compliant candidates through data analytics.

A fintech advisory panel also was created to review the regulatory processes for multistate licensing and supervision. The companies represented focus on payments and money transmission, consumer and mortgage lending, and banks. The goal for all industries is to support uniformity in the examination, creating a new technology platform inside NMLS 2.0 to better coordinate state exams, including in fintech. CSBS has also shared its focus on working with states to identify best practices and, when needed, to support state code changes to deliver improved supervision of all licensees, including future fintech firms. NMLS 2.0 is set to go live in time for user training before the 2018 renewal season that begins Nov. 1, 2018.

CFPB Reconsideration of Small-Dollar Lending Rule

On Jan. 16, 2018, the CFPB announced that it will reconsider the Small-Dollar Rule.[48] In part, the CFPB stated, "The Bureau intends to engage in a rulemaking process so that the Bureau may reconsider the Payday Rule [Small-Dollar Rule]. Although most provisions of the Payday Rule do not require compliance until August 19, 2019, the effective date marks codification of the Payday Rule in the Code of Federal Regulations. Today's effective date [Jan. 16, 2018] also establishes April 16, 2018, as the deadline to submit an application for preliminary approval to become a registered information system (RIS) under the Payday Rule."[49]

48 Consumer Financial Protection Bureau, "CFPB Statement on Payday Rule," https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-payday-rule/ (last visited Jan. 23, 2018).

49 *Id.*

Restructuring

Restructuring

Industry Developments

Chapter 11 bankruptcy filings in the United States have increased a slight 6 percent over 2016 to 6,794, a number that is still below the bankruptcy filing volumes seen in the wake of the Great Recession. Overall bankruptcy filings, however, decreased by 5 percent in 2017.[50] Total filings in the Bankruptcy Appellate Panels (BAPs) remained steady, rising only 1 percent. Consumer cases accounted for 97 percent of all bankruptcy petitions in 2017. The number of publicly traded companies filing for bankruptcy fell to 70 from 99 in 2016. However, the total assets of public companies going into Chapter 7 and Chapter 11 during 2017 rose by almost $3 billion. While oil and gas businesses dominated the commercial bankruptcy filings in 2016, retail led the way in 2017. Healthcare-related bankruptcies also saw an increase, as the demands of the healthcare industry have increased pressure on those businesses.

Retail

The decrease in brick-and-mortar retail shopping continues at a steady pace as online retailers capture market share. Retailers also constitute a growing presence among Chapter 11 filers, with 2017 marking a record year for retail bankruptcy filings. More than 8,053 store closures were announced. Some of the most notable retailers to file for Chapter 11 include Toys R Us, Gymboree, hhgregg, Wet Seal, Rue 21, Vitamin World, Payless, Gordmans, BCBG Max Azria and The Limited.

Energy

Although Chapter 11 activity in the energy and mining sectors remained significant in 2017, it no longer dominated the bankruptcy field as it did in 2016. Of the 10 largest Chapter 11 filings, only four were energy or mining companies, compared with eight of the top 10 in 2016.

Representative Matters

Mezzanine Workout

Representing a secured lender in connection with the workout and restructuring of its subordinated claims in a highly leveraged transportation company with an enterprise value in excess of $250 million.

Subprime Lender

Represented the principal investor in connection with the restructuring and related litigation for a subprime lender. The restructuring and related litigation involved a complex capital structure and multiple years of litigation spanning several courts.

Tail Fee Litigation

Assisted an international investment bank in litigation arising out of a tail fee in connection with the Chapter 11 bankruptcy of a large oil and gas company with more than $400 million in debt.

50 Federal Judicial Caseload Statistics 2017, United States Courts, Administrative Office of the United States Courts.

Restructuring

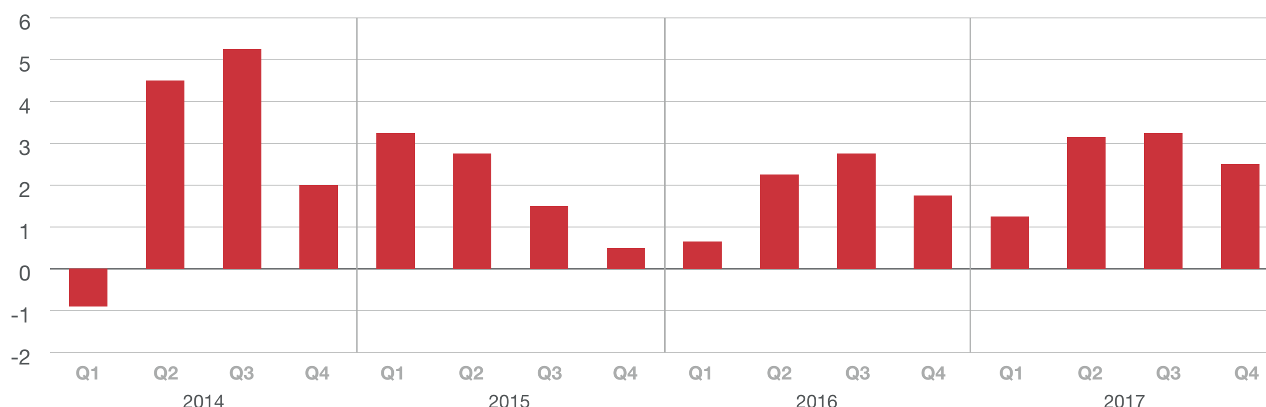
Distressed Hospitality Litigation

Represented an S&P-rated servicer in connection with the resolution of a portfolio of several defaulted commercial hospitality loans throughout Northern and Central Ohio with more than $7 million at stake. We succeeded in resolving five of six loans through summary judgment and prevailed at trial on the sixth. The litigation was particularly complex due to the need to litigate issues of the interpretation of a cross-guaranty agreement and to obtain the prompt dismissal of multiple Chapter 11 bankruptcy proceedings commenced by the borrower in an effort to frustrate the creditor's collection efforts.

Emerging Issues and Trends

While at the outset of 2017, some economists predicted a bear market the year turned out to be marked by consistent GDP growth.[51]

Real GDP: Percent change from preceding quarter



U.S. Bureau of Economic Analysis

Seasonally adjusted at annual rates

Delinquency rates for commercial and residential real estate loans remained at record lows as of the fourth quarter of 2017, hitting 3.54 percent for residential loans and 0.74 percent for commercial loans.[52] Market analysts suggest that the retail, oil and gas, and healthcare sectors will face continued challenges in 2018.[53] Restructuring practitioners saw a few legal developments in the law in 2017. In *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017), the U.S. Supreme Court reversed an Eleventh Circuit decision that had allowed claims under the FDCPA to proceed against creditors for filing proofs of claim in bankruptcy that were, on their face, barred by the applicable statute of limitations. Relying on Alabama law, the plain text of the bankruptcy code and the fact that bankruptcy claims are reviewed by bankruptcy trustees (who are sophisticated parties), the Court held that the act of filing a proof of claim for a debt that is beyond the statute of limitations was neither "false, deceptive, or misleading" nor "unfair" or "unconscionable" under the FDCPA.

51 U.S. Bureau of Economic Analysis, National Income and Product Accounts, Feb. 28, 2018, at: https://www.bea.gov/newsreleases/national/gdp/2018/gdp4q17_2nd.htm (visited March 7, 2018).

52 Federal Reserve Board, Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, at: https://www.federalreserve.gov/releases/chargeoff/delallsa.htm (visited March 7, 2018).

53 Steve Fleming, PWC, Restructuring trends: What did we see in 2017 and what lies ahead in 2018? at: http://usblogs.pwc.com/deals/restructuring-trends-what-did-we-see-in-2017-and-what-lies-ahead-for-2018/ (visited March 7, 2018).

Restructuring

In *In re MPM Silicones, LLC*, 874 F.3d 787 (2d Cir. 2017), the Second Circuit adopted the use of a market rate to determine cram-down interest rates in a Chapter 11 case. This case may be used by secured lenders to seek higher interest rates than what would normally apply under the Supreme Court's plurality decision in *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) in the Chapter 13 context. The Second Circuit wrote that the "market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality." 874 F.3d at 800, quoting *In re American HomePatient, Inc.*, 420 F.3d 559, 568 (6th Cir. 2005). This decision is seen as giving more leverage to prepetition secured lenders in plan negotiations. The decision also made law in the area of make-whole premiums, as it held that prepetition lenders were not entitled to a make-whole premium where their notes were automatically accelerated by virtue of the bankruptcy filing, and it rejected an effort by the lenders to rescind the notes' acceleration. *Id.* at 802-804.

Conclusion and Contact Us

Conclusion

As illustrated by this review, 2017 was an impactful year for the financial services industry. Developments included the tumultuous turnover at the top of the CFPB, the rise and fall of the consumer arbitration rule, and important developments in the case law involving consumer protection statutes such as the TCPA, the FDCPA and the FCRA. Thus far, 2018 is bringing additional change as new leaders settle in at top financial regulatory agencies. We continue to monitor the financial services landscape. Stay tuned to our team's Financial Services Blog and sign up for our periodic Client Alerts for practical information and advice about succeeding in this volatile environment. Feel free to reach out to us for help with issues that affect your business and your clients.

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