CONSUMER FINANCIAL SERVICES LAW REPORT

FOCUSING ON SIGNIFICANT CASELAW AND EMERGING TRENDS

AUGUST 1, 2011 | VOLUME 15 | ISSUE 5

PREEMPTION

NBA DOESN'T PREEMPT STATE DEBT COLLECTION STATUTE

A state law that generally prohibits inappropriate debt collection practices among all creditors and does not prevent or significantly interfere with the business of banking is not preempted by the National Bank Act under implementing Office of the Comptroller of the Currency regulations, a federal court has held. The court therefore denied dismissal of a bankrupt borrower's claim that a lender's collection activities surrounding her past-due mortgage loan violated the Florida Consumer Collection Practices Act. (*Bate v. Wells Fargo Bank, N.A. (In re Bate)*, No. 8:10-ap-01289-MGW, 2011 WL 2469689 (Bankr. M.D. Fla. 06/22/11).)

"There is no significant regulatory objective that would merit preempting a state law of general applicability that is designed to protect consumers from unscrupulous and egregious activity by debt collectors," found Judge Michael G. Williamson of the U.S. Bankruptcy Court, Middle District of Florida. "The FCCPA may restrict the frequency, procedure, and substance of contacts permitted between [the lender] and its customers, but it only does so to the extent of requiring that such collection contacts not be abusive, deceptive or unfair. [The lender] may still make loans. It may also collect on those loans, but it must abide by the FCCPA when doing so, just as every other debt collector in Florida must do."

Opal Bate sued Wells Fargo Bank NA in bankruptcy court, seeking damages for violations of the FCCPA in 35 counts — 33 of them for contacting her while knowing she was represented by an attorney; one for impermissibly contacting her after 9:00 p.m. and before 8:00 a.m.; and one for harassment — when the bank tried to collect on the past-due balance of her mortgage loan. Wells Fargo moved to dismiss, arguing that all 35 counts were preempted by the NBA.

INSIDE

CONSUMER NEWS 4

GUEST COMMENTARY

HELOCked: Putative class survives dismissal under 'responsible lending' standard 5

By Valerie L. Hletko and Jonathan D. Jerison

FAIR CREDIT

CRA's responses to ID theft victim's dispute 'vague and unclear' 7

FAIR DEBT

State law lassoes HELOC lender as debt collector 9

Balance-due letter no FDCPA violation; default judgment attachment is 10

MORTGAGE LENDING

The question remains: Who misrepresented borrower's job and income? 11

CLASS ACTION

Only one HAMP putative class survives court's scrutiny 13

DEBIT CARDS

Dust-up over interchange fee rule clouds industry 14

LAWS, RULES & REGS UPDATE 16

TCPA

Pending FCC regulation insufficient to invoke 'primary jurisdiction' doctrine 17

ALSO IN THE COURTS

Quick takes on notable consumer financial services decisions 18

CONFERENCE CALENDAR 20

41189411

WEST®

partment of Defense website and their own files to determine the military status of a person before they foreclose on him or her," noted assistant AG Thomas E. Perez in a recent speech. "These measures will not only prevent SCRA violations at Bank of America/Countrywide and Saxon, but will set an industry gold standard for all other servicers that to follow in meeting their obligations."

FAILURES 'REVERSE' IN MORE WAYS THAN ONE

Fewer mortgage-lending banks went out in 2010's first half than failed in last year's first half, but more credit unions have gone under, according to a recent study. And while only 10 non-banks exited the business during the first six months of 2011 — two fewer that the 2010 figure — the number included four reverse mortgage companies.

Overall, 74 mortgage-related firms failed or closed down in the first half of 2011 (compared to last-year's count of 109): 48 banks (86), 16 credit unions (11), and 10 non-banks (12), according to *mortgagedaily.com*.

The four reverse mortgage businesses among the non-banks that went down stemmed from Bank of America Home Loan's decision to exit its reverse-mortgage lending channel; Wells Fargo Home Mortgage's intention to stop offering reverse mortgages through its wholesale lending channel, followed by Wells Fargo's announcement that it would stop originating home-equity conversion mortgages entirely; and OneWest Bank Group's closing of its reverse-mortgage subsidiary Financial Freedom.

Find more at mortgagedaily.com/MortgageGraveyard.asp?spcode=pr.

GUEST COMMENTARY

HELOCked: PUTATIVE CLASS SURVIVES DISMISSAL UNDER 'RESPONSIBLE LENDING' STANDARD

By Valerie L. Hletko and Jonathan D. Jerison, BuckleySandler LLP

Valerie L. Hletko and ***Jonathan D. Jerison*** are counsel with the Washington, D.C. office of ***BuckleySandler LLP***. They represent financial services companies in connection with government enforcement proceedings, regulatory examinations, investigations, compliance counseling, and litigation. Reach them at *vhletko@buckleysandler.com* and *jjerison@buckleysandler.com*.

It was a not unexpected result at the motion to dismiss stage: On June 30, 2011, the Northern District of Illinois permitted borrowers in a multi-district litigation putative class action to go forward with claims that JPMorgan Chase Bank NA impermissibly reduced or suspended their home equity lines of credit. (*In re JPMorgan Chase Bank Home Equity Line of Credit Litigation*, No. 10 C 3647, 2011 WL 2600573 (N.D. Ill. 06/30/11).)

Chase had moved for dismissal for failure to state a claim under Rule 12(b)(6), arguing that federal law and governing contractual provisions permit it to reduce or suspend the HELOCs at issue. The district court disagreed, and its holding has created uncertainty about whether HELOC lenders can continue to rely on a safe harbor in the Federal Reserve Board's Official Commentary to Regulation Z, the Truth in Lending Act's implementing regulation.

That safe harbor has allowed them to reduce or suspend a HELOC line when a decline in value wipes out half of their original equity cushion, regardless of the borrower's current equity in the property. The court's explicit application of a "responsible lending" standard to HELOCs may have a negative effect on settlement negotiations in similar cases and create uncertainty in the management of HELOC portfolios going forward.

REGULATION Z LIMITS

Regulation Z requires that HELOC terms be honored for the original term of the plan, but there are three main categories of exceptions:

1) Under 12 C.F.R. § 226.5b(3)(vi), a lender may terminate and accelerate a line based on borrower behavior, including fraud or material misrepresentations, the failure to meet repayment terms, or the borrower's impairment of the security by, for example, selling the property or failing to maintain insurance.

2) Under § 226, Supp. 1, 5b(f)(3)(vi)(A)-6a, the lender may temporarily suspend advances or reduce the credit limit for a borrower in good standing if there is a significant decline in the property's value or the lender reasonably believes that the borrower will be unable to fulfill repayment obligations because of a material change in financial circumstances. The lender must reinstate the borrower's credit privileges or restore the credit limit once the condition that precipitated the suspension or reduction is obviated.

3) The FRB's Commentary provides that a property's decline in value must be "significant," but the practical meaning of the term "will vary according to individual circumstances."

The Commentary provides that one way to measure significance is to consider the impact of a decline in value on the "available equity" — the difference between the property value and the sum of prior liens and the HELOC credit limit, both measured at the time the line was

© 2011 Thomson Reuters

opened. The Commentary deems a decline in available equity of 50 percent or more to reflect a significant decline in the value of the property, allowing the creditor to temporarily suspend or reduce the credit line.

Thus, a line secured by a property appraised at $100,000 with a $50,000 first lien and a $30,000 credit limit is subject to a suspension or reduction if the property value drops by $10,000 (since the available equity, having gone from $20,000 to $10,000, declined by 50 percent). A lender may also suspend or reduce a credit line outside the safe harbor provided that it can otherwise show a significant decline in value.

While *In re JPMorgan Chase* recognizes that the Commentary's safe harbor provision is considered controlling law, "absolving a lender from liability for reductions that occur based on declines in value within the 'safe harbor' parameters," the court did not seem to fully appreciate that compliance with the Commentary shields a lender from civil liability by statute. In addition, the court did not recognize the practical difficulties that lenders could face in determining present available equity, which could involve a title search and contacts with senior lien-holders.

It is difficult to predict the long-run impact of the decision in light of the pleading standards imposed at the Rule 12 stage, but the case raises questions about the security of the safe harbor.

THE DISTRICT COURT'S OPINION

The plaintiffs alleged that Chase violated TILA and Regulation Z, by (i) suspending and reducing HELOCs in the absence of a significant decline in the value of the property securing them, and then improperly failing to reinstate them; (ii) using inaccurate and unreliable methods to calculate the value of the properties securing the HELOCs; (iii) failing to consider the amount of available equity in the plaintiffs' homes before determining that their value had declined significantly for purposes of TILA and Regulation Z; and (iv) using unlawful triggering events to suspend or reduce HELOCs. They also alleged that Chase's suspensions or reductions (and the manner in which they were effectuated) constituted breaches of contract, breaches of the implied covenant of good faith and fair dealing, unjust enrichment, and violations of state consumer protection laws.

First, the plaintiffs claim that Chase violated TILA and Regulation Z by reducing or suspending their HELOCs absent a significant decline in value. Chase argued in its motion to dismiss that this allegation was insufficient because it had, in fact, conducted valuations showing declines in value. Noting that the plaintiffs alleged that they obtained their own later valuations showing that property values had recovered, the court held that the plaintiffs' allegations were sufficient to support an inference that either Chase's valuations were unreliable or that the property values did not decline to the extent claimed.

Second, the plaintiffs alleged that Chase violated TILA and Regulation Z by failing to consider the present available equity in their homes. The court rejected Chase's argument, supported by another district court opinion, that TILA and Regulation Z require only consideration of the decline in the value of the home from when it was originated as compared to the original available equity.

The court concluded that present available equity "should in fact play some role in a responsible creditor's lending decision — after all, the amount of a HELOC is based on the amount of equity in the home; it makes little sense to suggest that an increase in the amount of that equity will have no bearing on the HELOC."

Therefore, the plaintiffs' allegations that their HELOC reductions were not related to the actual value of their homes or their homes' equity, taken as true, would "contravene TILA's purpose of 'economic stabilization' for consumers and informed credit usage and potentially compromise the borrower's credit score."

Third, the plaintiffs alleged that Chase relied on inaccurate and unreliable automated valuation models. In its motion, Chase pointed to the absence in Regulation Z of any requirement that a creditor obtain an appraisal before suspending a HELOC and a proposed rule specifically endorsing AVMs. The court noted (and the plaintiffs conceded) that AVMs do not per se violate TILA or Regulation Z, but said that its decision did not turn on their propriety. If their use "contributed to improper reductions or suspensions of HELOCs," they will be relevant, in the court's view, to showing that Chase failed to establish a significant decline in property values.

Fourth, the plaintiffs alleged that Chase utilized a 5 percent decline in property value as a "triggering event" to suspend or revoke their HELOCs, effectively arguing that Chase violated TILA by devising its own metrics for decisions relating to the suspension or reduction of HELOCs. Chase argued in its motion that this allegation attempts to impose extraneous prohibitions (beyond those enumerated in TILA and Regulation Z), and that the plaintiffs failed to allege a specific value that would constitute a significant decline.

While the Commentary explains that "a contract cannot contain a provision allowing the creditor to freeze a line due to an insignificant decline in property value since the regulation allows that response only for a significant decline," the court found that the plaintiffs adequately alleged the absence of a significant decline.

Finally, the plaintiffs alleged that Chase reduced or suspended their HELOCs without a "sound factual basis." Chase argued in its motion that TILA and Regulation Z impose no such standard, but, again, the court considered the allegation in view of an alleged overarching pattern of unfairness.

 © 2011 Thomson Reuters

UDAP PRINCIPLES KEY TO DECISION

District Judge Rebecca R. Pallmeyer's reliance on unfair and deceptive acts or practices concepts underscores the importance of 'fair and responsible lending' considerations in account management practices. For example, the federal banking agencies and the National Credit Union Agency in 2005 issued an interagency guidance, *Credit-Risk Management Guidance for Home-Equity Lending*. In 2008 the FDIC and OTS issued FIL 08-58 and CEO Letter #276, respectively, which expanded upon the interagency guidance, emphasizing fair lending principles and safeguards against UDAPs in addition to TILA compliance.

The court in the end determined that each of the allegations was adequately pled and may be relevant in evaluating whether Chase violated TILA and Regulation Z by reducing or suspending HELOCs in the absence of a significant decline in property value. The court denied Chase's motion to dismiss the plaintiffs' claims for declaratory relief, concluding that they may form a viable alternative remedy inasmuch as statutory damages available under TILA do not adequately compensate each class member. The court also held that the plaintiffs' allegations stated state-law breach of contract and UDAP claims.

While it is difficult to predict the ultimate impact of this case given its early stage, lenders can take steps to protect against the risks it raises by (i) ensuring that their policies, procedures, and practices incorporate fair and responsible lending principles and take UDAP issues into account; and (ii) taking proactive measures to diminish vulnerability in connection with valuation. These measures include a second review by senior personnel of any borrower appraisal, employee training focused on resolving (rather than defending) any valuation dispute, and regular management review of valuation dispute patterns.

FAIR CREDIT

CRA'S RESPONSES TO ID THEFT VICTIM'S DISPUTE 'VAGUE AND UNCLEAR'

When it comes to the reinvestigation a consumer's dispute of his credit report, what a CRA says in response to the consumer appears at least as important as how it is said. A recent federal court decision provided the example, allowing a purported identity theft victim's claims that a credit reporting agency violated the Fair Credit Reporting Act to go to trial. The court found that the CRA's boilerplate responses to the consumer's dispute of his credit report were "vague and unclear." The district court ruled that if the CRA's replies defined its entire dispute reinvestigation procedure, it could be liable for violating the FCRA. (*Lazarre v. JPMorgan Chase Bank, N.A., et al.*, No. 10-23250, 2011 WL 2508161 (S.D. Fla. 06/23/11).)

A bank account was opened at Washington Mutual Bank in 2007 with Fabrice Lazarre's identity and used for fraudulent activity involving checks. Lazarre asserted he was the victim of identity theft and denied that the WaMu account was his after Early Warning Services LLC, a credit reporting agency, reported the fraudulent activity on the WaMu account to Wachovia Bank. Lazarre's longstanding account with Wachovia was placed on financial hold in October 2009, the same month that Lazarre first notified Early Warning that it was incorrectly reporting the WaMu account and associated fraudulent activity on its consumer reports.

In November 2009, Early Warning contacted JPMorgan Chase Bank NA for verification, and later informed Lazarre that Chase had confirmed the WaMu account belonged to him and had been used by him to engage in fraudulent activity. Lazarre again responded that the WaMu account did not belong to him and that early Warning's consumer report was incorrect, which he reiterated on multiple occasions. Early Warning invariably responded:

> We have completed a reinvestigation of your file. The results of our investigation confirm that some of the information you provided to Wachovia was reported to us by another financial institution(s) as inappropriately used, and that the information reported to us resulted in a financial loss to, or other potential loss with respect to, the reporting financial institution(s).

On May 25, 2010, Lazarre again disputed the allegedly fraudulent entry and, on June 2, 2010, Early Warning responded:

> As a consumer reporting agency, Early Warning Services is obligated to involve a Furnisher of information contained in a file in the reinvestigation of that information. Early Warning Services gathers all pertinent information regarding the request for reinvestigation of the disputed record and forwards such information along with the request to the Furnisher. Early Warning Services tracks the reinvestigation period to ensure that the Furnisher completes the reinvestigation within the time frame allowed by the Fair Credit Reporting Act.
>
> The Furnisher's reinvestigation includes a complete review of the facts regarding the contributed data. Based upon its reinvestigation, the Furnisher determines whether the information is accurate, inaccurate or incomplete. Upon