YEAR IN REVIEW

BCLP Class Action Practice Group Financial Services Team

2019 ROUNDUP – 2020 PREVIEW

YEAR IN REVIEW

CONSUMER CLASS ACTIONS AS WELL AS FINANCIAL SERVICES REGULATORY AND ENFORCEMENT ACTIVITY PROLIFERATED 2019.

Focus areas included FCRA, Fair Lending, ancillary fees and services (such as lender placed flood insurance), TCPA, privacy and data security and other topics. Consumer Financial Protection Bureau's Director Kathleen Kraninger completed her first full year in role and established a number of priorities. The OCC released its supervisory priorities including cybersecurity, Bank Secrecy Act/ AML compliance, and continued focus on commercial and retail underwriting practices and operations controls. The FTC continues to advance its agenda regarding privacy and truthful advertising. State Attorneys General (including through NAAG committee projects and ad hoc multi-lateral cooperation projects) continue to focus on consumer protection, plain disclosures and fair dealing.

Looking forward in 2020, what might we expect to see developing in the financial services litigation environment?

Continued active Plaintiffs' class action bar focusing on disclosures and accuracy in banking services; commercial litigation relating to LIBORindex changeover; potential regulatory enforcement or class actions involving environmental sustainability representations and warranties in the lending context, continuing focus on fair lending, privacy and at risk consumer populations, such as the elderly or veterans/ active military personnel.

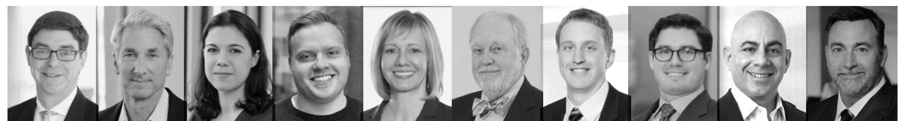
This Roundup provides a recap of a variety of key developments and summarizes a number of interesting federal case rulings. It is not an exhaustive survey of rulings in state and federal courts nationwide, but should help provide flavor for the current environment as we look forward to 2020.

Highlighted in this Issue:

- CFPB Director Kraninger's 2019 Priorities & 2020 Constitutionality Developments
- Federal Case Developments of Note
- 2020 Issues to Watch
- FTC 2019 Class Notice Study

The Financial Services Round Up was compiled and edited by Douglas Thompson.

Contributors to the Financial Services Round Up include:



MARK BRENNAN · JIM GOLDBERG · SAMANTHA GOLDBERG-SEDER · ROSS HANDLER · JENNIFER JACKSON · RODNEY PAGE · MATT PETERSEN · JONATHAN POTTS · BENJAMIN SAUL · DOUGLAS THOMPSON

CFPB DEVELOPMENTS & PRIORITIES

Director Kathleen Kraninger's 2019 Priorities & 2020 Constitutionality Question

Director Kathleen Kraninger has just completed her first year in role. At the December 2019 National Association of Attorneys General (NAAG) conference, she outlined a number of her leadership themes, the Bureau's 2019 activities, as well as on- going 2020 priorities.

Collaboration with States: Kraninger confirmed "I want to have an open and direct relationship with you all, particularly in those instances where there may be a divergence of views on policy matters. We will have differences in views from time to time. But what unites us–a shared commitment to protecting consumers–is greater than what divides us." She indicated that she and the Bureau are focused on new partnership efforts with the states, including innovation projects and policies. Kraninger noted "In fact, the Dodd-Frank Act specifically contemplates joint investigations and requests for information....Under [her] leadership, the Bureau is committed to bringing together partners from across sectors to develop and execute strategies to achieve a common goal." An example of joint collaboration is the American Consumer Financial Innovation Network (ACFIN) launched this year to promote and pilot innovation by providing "regulatory certainty for innovators."

"Culture of Compliance & Righting Wrongs: "Kraninger used the phrase to describe her proactive approach to supervision & enforcement. She emphasized that the Bureau will focus on the facts and law in its efforts: "A purposeful supervisory and enforcement regime can prevent consumer harm by promoting a culture of compliance and righting wrongs. Indeed, when we take enforcement action against wrongdoers, it sends a clear message to the public and to the marketplace that we will not tolerate illegal conduct. This deters unlawful behavior and supports a level playing field among competing firms. The bottom line is that we will effectively enforce the law to fulfill our consumer protection mission." She outlined a number 2019 supervision & enforcement metrics including:

- 22 public enforcement actions commenced
- 6 previous enforcement lawsuits settled
- Final judgments totaling more than $777million in total consumer relief (including $600 million in consumer redress and $174 million in other relief)
- $185 million in civil money penalties
- "Millions in restitution to over 247,000 consumers" in connection with supervisory activities
- 133 supervisory events commenced at supervised entities
- 147 supervisory events completed at supervised entities
- 433 MRAs (matters requiring attention)

Candid Information Gathering: Kraninger clearly is proud of her inclusive 2019 outreach efforts and listening tour. She noted "In the past 12 months, I have met with more than 800 stakeholders in the realm of consumer protection, including attorneys general and state financial regulators, consumers, consumer groups, tribal leaders,military personnel, academics, nonprofits, faith leaders, and both bank and non- bank financial institutions." Kraninger indicated that in 2019

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she had visited with 17 states (generally having met with the AGs) and plans to visit more in 2020. Other 2019 activities and priorities the Bureau announced in public releases earlier in the year include the following.

Consumer Reporting Supervisory Highlights. The Fall 2019 Special Report (issued in early December 2019) focused on the topics for credit furnishers (including supervised banks, mortgage servicers, auto loan servicers, student loan servicers, and debt collectors): adopting reasonable written policies and

procedures (compliant with Reg. V); prohibition of reporting information where the furnisher has actual knowledge of errors (including clearly and conspicuously notifying consumers of the address to send notices of inaccuracy); furnisher's duty to correct and update information; furnisher's duty to provide notice of delinquency of accounts within 90 days of the first delinquency, and furnisher's obligations of reasonable and timely investigation upon notice of dispute. The Report also addresses a number of issues for consumer reporting companies (as defined in the FCRA, 15 USC § 1681a including nationwide consumer reporting agencies and nationwide specialty consumer reporting agencies): adopting reasonable procedures to assure maximum possible accuracy of reporting; limiting the furnishing of consumer reports to permissible purposes; blocking information resulting from identity theft, and implementing robust dispute investigation procedures.

Consumer Complaint Database Enhancements. On September 18, the Bureau announced it will continue to publish consumer complaints including data fields and narratives. To address in part criticisms about the information shared, the Bureau will implement enhancements including: (a)modifying disclaimers to provide context, (b) changing the consumer complaint submissions process to provide additional information before the complaint is submitted, and (c) enhanced information contacts at financial institutions who can provide specific answers to certain consumer questions. In connection with these changes, the Bureau will develop "dynamic visualization tools including geospatial and trend views" and emphasize features for "aggregation and analysis" of the underlying data fields. Finally, the Bureau is evaluating tools that will allow financial institutions to "respond publicly" to individual complaints in the database. In a published speech at the National Consumer Empowerment Conference, the Director acknowledged that she has met with "more than 700 consumer groups, consumers, state and local government officials,military personnel, academics, non- profits, faith leaders, financial institutions, and former and current Bureau official and staff" as part of her listening tour. In her view, enhancements to the database will address a variety of concerns from a variety of constituents (Kraninger "did not see this as a binary choice" to publish data or not).One important note, the Director offered: "It is imperative that we make it known the Consumer Complaint Database is not a statistical sample of consumers' experiences in the marketplace."

Additional December 2019 reports demonstrate areas of resource investment for the Bureau and likely signal areas of focus for 2020. While none of the reports specifically addresses consumer class action litigation, the practices being monitored and issues discussed ultimately may become fodder for consumer class action litigators. Accordingly, these reports are worth your attention.

- CFPB Ombudsman's Office 2019 Annual Report (December 5, 2019)
- 2019 Financial Literacy Annual Report (December 23, 2019)
- Annual Report on the TILA, EFTA, and CARD Act (December 18, 2019)
- College Credit Card Report (December 31, 2019)

2020 Unconstitutionality Challenge. In September 17, 2019 "Constitution Day" letters to Senate Majority Leader Mitch McConnell (R- KY) and House Speaker Nancy Pelosi (D- CA), Director Kraninger advised that the CFPB "has determined that the for- cause removal provision of the Consumer Financial Protection Act of 2010 (CFPA), 12 U.S.C. § 5491(c)(3), is unconstitutional." The Director added: "It is in the Bureau's interests to obtain a final resolution of this issue as soon as possible," noting the Bureau supports SCOTUS review of the conflict manifested in Circuit rulings between Congressional enactment provisions and the Bureau's current position.

Apparently, SCOTUS was listening and agreed to hear the Seila Law v. Consumer Financial Protection Bureau, setting oral argument for late February 2020. See the SCOTUS Blog link here: https://www.scotusblog.com/case- files/cases/seila- law- llc- v- consumer-financialprotection-bureau/

In an interesting twist, before granting review in October 2019, SCOTUS appointed former US Solicitor General Paul Clement to argue in support of the CFPB's structure, given the current Director's and the current DOJ's position. Should be fascinating to hear the parties' respective advocates, friends of the Court and, of course, the Justices' queries.

HIGHLIGHTED FEDERAL CASELAW DEVELOPMENTS:

Overdraft Fees: Consumer Account Agreements& Opt-Ins Should Unambiguously Disclose the Applicable Account Balance Calculation Methodology

***Tims v. LGE Community Credit Union,* 935 F.3d 1228 (11th Circuit Court of Appeals, August 2019)**

The Eleventh Circuit reversed the district court's dismissal of plaintiff's class action claims alleging improper disclosure and utilization of account balance calculations for assessing overdraft fees. Plaintiff and the putative class asserted claims for violations of the Electronic Funds Transfers Act (EFTA), 15 USC § 1693- 1693r, among other common law contract and equitable claims. The Court of Appeals concluded that the underlying account agreements "are ambiguous as to whether LGE could rely on an account's available balance, rather than its ledger balance, to assess overdraft fees." The Court noted that the Federal Reserve Model Form A- 9 (12 CFR§ 1005.17 et seq.) does not address specifically which method (ledger balance which considers only settled transactions or available balance which also includes authorized but not settled transactions as well as deposits on hold which have not yet cleared).

In reversing the dismissal, the Court focused on two provisions in the agreements to discern what "enough money in your account" meant (quoted language from Opt- In agreement). The Court found those provisions

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utilize, in turn, additional ambiguous terms, i.e. "sufficient funds" and "available." The Court concluded in reviving the claims that "the parties' intent will become a question for the jury should neither party be granted summary judgment." Finally, the Court refused to apply the disclosure form safe harbor to defeat Plaintiff's claims, because "the content of the Regulation E disclosure is at issue" not the procedures by which the disclosure is given (e.g. in writing with electronic acknowledgment).

This ruling highlights the importance of specific content and clarity of definitions,methodologies and descriptions in account agreements. In what may be a silver lining to the class action aspect of the case, it may be that Court's focus on the parties' specific intent as to each account holder may later lead to a lack of predominance of common issues and questions required to certify the class under Rule 23.

APR Calculation Methodology Must Be Clear and Unambiguous in Terms & Conditions and FAQs

In re Fifth Third Early Cash Advance Litigation (Lori Laskaris, et al. v. Fifth Third Bank), 925 F.3d 265 (6th Circuit Court of Appeals, May 2019)

The Sixth Circuit reversed the district court's dismissal of Plaintiffs' putative class claims asserting that the APR disclosed in connection with the lender's Early Access short term loan program was misleading. Plaintiffs asserted state and federal claims including breach of contract under Ohio Law. They claimed the methodology disclosed in the account agreement for calculation of the loan's APR was misleading, and that instead of resulting in the Bank disclosed 120%APR, the actual APR "was in fact as high as 3650%." In particular, plaintiff's complaint that since the loans never reach a year in term and because the transaction fee is calculated based on the borrower's 12month statement cycle, the APR disclosed is misleading. The Court found the ambiguity stemmed from two definitions in the agreement, the first being quoted verbatim from applicable TILA regulations, 15 USC § 1601et seq. and Reg. Z12 CFR§ 226, et seq. ("APR as being expressed as a yearly rate") versus a second which "was not based on a year or any other time period."

In overturning the lower court, the Court highlighted "what complicates things is that one is a definition while another is a formula; the two naturally expressed in different ways...a reasonable person would recognize that the two don't mean exactly the same thing, but would expect them to be consistent." The court concluded that the two were inconsistent.

A concise Dissent notes, however, that while possibly "idiosyncratic," the contract language is "abundantly clear" in tying the "APR to the transaction fee and the borrower's statement cycles" and clearly disclosing that a "10%transaction fee is assessed without regard to the length of time the loan remains outstanding."

The Dissent argues that the parties can agree to whatever contract terms they see fit and that plaintiffs got the "benefit of their bargain."

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Here, it appears ubiquitous federal regulatory terminology was not easily applicable to the instant short term loan product. Continuing to focus on plain meaning of disclosure and simplification whenever possible should help mitigate risk of potential consumer confusion and allegations of harm.

RESPA Statute of Limitations Is Not Jurisdictional & Fraudulent Concealment Was Alleged Sufficiently

Mary Edmonson v. Eagle National Bank, et al. 922 F.3d 535 (4th Circuit Court of Appeals, April 2019)

The Fourth Circuit Reversed the District court's dismissal of Plaintiff's and the putative classes' RESPA claims regarding alleged unearned fees and kickbacks relating to title services in connection with mortgage loan origination. The lower court had refused to toll the RESPA one year statute of limitations based on Plaintiff's allegations of fraudulent concealment and according to the Court erroneously applied the SCOTUS Menonminee two-step equitable tolling test for assessing allegation of fraudulent concealment (136 S. Ct. 750, 755 (2106)).

In reversing the lower court ruling, the Court focused on its obligation to accept as true at the motion to dismiss phase Plaintiff's allegations regarding alleged "sham entities" and alleged "back dating" of agreements among various defendants, and other conduct which might support purported concealment. Second the Court concluded that Plaintiff had adequately alleged her own diligence under the applicable Marlinton three step test (71F.3d 119, 122 (4th Cir. 1995). The Court concluded that the exercise of due diligence is a question of fact and that Plaintiff need not allege she undertook any specific exploratory inquiry. In addition, the Court declined to hold as a matter of law that certain previously filed litigation placed Plaintiff on inquiry notice. The Court distinguished other cases where undisputed record evidence demonstrated Plaintiffs had been placed on inquiry notice. In its conclusion the Court invoked questions about what one might expect a "reasonable residential mortgage borrower to keep abreast of" in terms of enforcement and litigation relating to their lenders.

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SLUSA Does Not Bar Federal Court Jurisdiction For Trustee's State Law Imprudent Investment Breach of Fiduciary Duty Claims Nor Does It Bar Fee-Related Claims

Lindie Banks v. Northern Trust Corp., et al. 929 F.3d 1046 (9th Circuit Court of Appeals, July 2019)

The Ninth Circuit reversed the district's ruling holding that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) barred federal court jurisdiction over Plaintiff's putative class California law elder abuse and UDA Punfair competition claims stemming from allegedly "suboptimal returns" on asset investment services. The ruling focuses heavily on the parameters of the trustee- beneficiary irrevocable trust relationship and who has the power to act under applicable trust instruments. This is of critical importance in navigating the "in connection with purchase or sale of securities" language in SLUSA. Citing Chadbourne & Parke LLP v. Troice , 571U.S. 377 (2014), the Court found that any alleged fraudulent conduct "does not change the fact that the [trust's] beneficiaries are unable to purchase of sell covered securities." More precisely, the Court found that the operative complaint did not allege that beneficiaries make any investment decision based on defendants' conduct or statements. "Quite the opposite, the [operative complaint] alleges that [Plaintiff] had no control over how [Defendant] invested the trust's assets because [Plaintiff] was only the beneficiary of an irrevocable trust."

Similarly, the Court ruled that Plaintiff's fee- related claims contesting certain allegedly improperly charged and substantiated ancillary fees also were viable. The Court found that the fees "lack any plausible relationship to covered securities" and "do not allege conduct in relation to any securities transactions." This case contains an added pop- culture bonus. The Court distinguished its rationale from the writers of Game of Thrones. "But we will not render Troice meaningless the way the Game of Thrones rendered the entire Night King storyline meaningless in its final season." (Judge John Owens).

Signing the Mortgage Insufficient to Establish RESPA Standing – To Sue Under RESPA, One Must Have Signed the Loan, Not Just the Mortgage.

Keen v. Helson, 930 F.3d 799 (6th Circuit, July 2019)

RESPA creates a cause of action but says only "borrower[s]" can use it. 12 U.S.C. § 2605(f). In Keen, the Sixth Circuit joined the Fifth and Eleventh Circuits in holding that to have a cause of action under RESPA, a plaintiff must not only sign the mortgage, but also the loan.

A "borrower" is commonly understood and defined as someone who is personally obligated on a loan—who is actually borrowing money. Because the plaintiff had never signed the mortgage loan, as her ex- husband had, she could not maintain a claim under RESPA, even though she had an interest in the house that she mortgaged and her husband later transferred his interest in the house to her as part of their divorce, shortly before he died.

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The Court noted that Congress could have said that "any person" injured by a RESPA violation could sue, or that "mortgagors" or "homeowners" could sue, but it chose not to do so and specified only "borrowers" could.

New regulations from the CFPB now define a "borrower" in 12 U.S.C. § 2605(f) to include "successors in interest." But those regulations only became effective in April 2018, after the events that led to Keen. The plaintiff relied on these new regulations as persuasive authority, but the Sixth Circuit dismissed, because "when, as here, the text is clear, that is the end of the matter." Given this comment and the erosion of deference to regulations at the Supreme Court, one wonders whether the CFPB's expansion of the definition of "borrower" will survive a challenge.

While not a class action claim, the ruling may be relevant in the class context in defining the scope of putative classes and analyzing whether non- borrower testimony and conduct will prove essential at trial. This may result in predominance of individualized issues and lack of superiority and manageability.

9th Circuit Finds Inaccurate Credit Reporting Alone Does Not Confer Article III Standing

Jaras v. Equifax, Inc., Unpublished/ 2019 WL 1373198 (9th Circuit, March 2019)

Although unpublished, in Jaras, the 9th Circuit panel continued the debate regarding what constitutes concrete harm sufficient for Article III standing. The case dealt another setback to plaintiffs trying to establish Article III standing to assert a claim under the Fair Credit Reporting Act, 15 U.S.C. § 1681, et seq. ("FCRA"). The Ninth Circuit held that the plaintiffs' claims of inaccurate credit reporting alone, without additional allegations of actual harm, "fail[] to allege a concrete injury for standing." The Court also went a step further and held that allegations of a lower credit score, without allegations about how that lower score "impact[ed] lending decisions," were equally insufficient to establish the accompanying injury necessary to meet the concreteness standard set forth in Spokeo, Inc. v. Robins, 136 S. Ct. 1540 (2016) ("Spokeo II"). Although the Ninth Circuit's decision is unpublished, it nonetheless raises the bar for FCRA plaintiffs to plead their way into federal court by confirming that alleged statutory violations—even allegations of inaccurate credit reporting—must be accompanied by a real world injury.

Jaras plaintiffs alleged that he or she had filed for Chapter 13 bankruptcy and the bankruptcy court confirmed his or her proposed bankruptcy plan. The plaintiffs contended that the confirmation of the Chapter 13 plans changed the legal status of their debts, and that it was inaccurate for the defendant credit reporting agencies to report their debts without referencing that the debts were subject to bankruptcy plans and may not be subject to repayment. The plaintiffs contended that the defendants' reporting

violated Section 1681i of the FCRA, which obligates credit reporting agencies to investigate consumer disputes, and California's Consumer Credit Reporting Agencies Act, Cal. Civ. Code § 1785.25(a).

The defendant credit reporting agencies moved to dismiss or for judgment on the pleadings in each case, arguing that, as a matter of law, it was not inaccurate or misleading to report debts as delinquent while a bankruptcy proceeding is pending and before the debts are discharged. The Ninth Circuit did not reach the merits of whether the defendants' credit reporting was inaccurate. The Court instead affirmed the district court's dismissal of the claims on grounds that, under Spokeo II and III, the plaintiffs lacked Article III standing because their allegations of inaccurate credit reporting were simply statutory violations and the plaintiffs failed to make any accompanying allegations sufficient to establish a concrete harm. In reaching that conclusion, the Ninth Circuit found statutory violations, such as the plaintiffs' allegations of inaccurate credit reporting, are not alone a concrete harm. To establish a concrete harm, the plaintiffs needed to make accompanying allegations of real world harm, such as an "allegation of the credit reporting harming Plaintiffs' ability to enter a transaction with a third party."

The Court distinguished facts in the Spokeo II and III rulings, where plaintiff alleged that the inaccurate credit reporting impacted his employment prospects. The Ninth Circuit noted here the Jaras plaintiffs "did not say anything about what kind of harm

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they were concerned about." The plaintiffs' "[b] road generalizations" about how lower credit scores can impact lending decisions—which were the only damages allegations in the various complaints—did not establish a concrete injury because the plaintiffs did not specifically allege how a lower score actually impacted them. Nor was it "obvious" that a lower credit score would have any impact on plaintiffs, "given that [their] bankruptcies themselves cause[d] them to have lower credit scores with or without the alleged misstatements."

Circuit Judge Marsha S. Berzon dissented, asserting that allegations of inaccurate credit reporting should always be deemed sufficient to establish a concrete injury.

Takeaways: Indeed, courts have been split as to whether statutory violations of Sections 1681b, 1681e, 1681i, and 1681s- 2(b) alone confer standing. No doubt other cases and judges will draw the lines differently depending on the facts alleged and their own convictions about concrete risk of harm to plaintiffs.

For more detail see BCLP Insights: https://www.bclplaw.com/en-US/thought-leadership/the-ninth-circuit-finds-inaccurate-credit-reporting-alone-does.html

The Risks of Assembling Consumer Information

Kidd v. Thompson Reuters, 925 F.3d 99 (Second Circuit, May 2019)

In a case of first impression in its circuit, the Second Circuit held that a business may not be liable under the Fair Credit Reporting Act (FCRA) for publishing false information unless it specifically intended the report to be a "consumer report." The Court held that defendant Thompson Reuters established it did not have the requisite specific intent by showing that at each step in its processes it instructed its users and potential subscribers that its platform was not to be used for FCRA purposes, such as employment eligibility—but only for the non- FCRA purposes of law enforcement, fraud prevention and identity verification—and required them to affirm their understanding of that restriction. Accordingly, the Second Circuit Court of Appeals affirmed the granting of summary judgment to Thompson Reuters, even though its subscriber had used its inaccurate report to determine a job applicant's employment eligibility.

Potential take- away: If your business regularly assembles consumer information, distributes it to third parties, and has concern it may be used for an unintended FCRA- related end, adopting disclosures (including forbidding such use) in your agreements and subscriber contracts may be appropriate. One may also consider whether it is feasible to monitor the actual third party uses of that information, and take adequate measures to stop any FCRA-related uses if such become known.

The Second Circuit noted that other circuits (including the 9th and 7th) have held that a business may not be liable under the Fair Credit Reporting Act for publishing false information unless it specifically intended the report to be a "consumer report." Zabriskie v. Fed. Nat'l Mortg. Assoc., 912 F.3d 1192 (9th Cir. 2019)(Fannie Mae's Desktop Underwriter platform is not a consumer report); Tierney v. Advocate Health & Hosps. Corp., 797 F. 3d 449 (7th Cir. 2015)(computerized patient data).

This case may be useful in defending consumer class claims asserted involving third party users of data or any related cross- claims potentially asserted by a consumer target defendant.

For more detail see Bank BCLP blog: https://bankbclp.com/2019/06/the-risks-of-assembling-consumer-information/

RESPA Is A Shield, Not A Sword

Germain v. US Bank National Association, 920 F.3d 269 (5th Circuit, April 2019)

In a case of first impression, the Fifth Circuit held that a defendant is not required to plead as an affirmative defense under the Real Estate Settlement Procedures Act that it had complied with Section 1024.41of the Code of Federal Regulations by responding properly to a borrower's loss mitigation application. The Court affirmed the dismissal of the borrower's RESPA claim on a summary judgment motion.

After repeated defaults beginning in 2009, the borrower Plaintiff Germain filed three or four loss mitigation applications, asking for loan modifications in 2012, 2013 and 2014, in addition to filing bankruptcy in 2013. Each time, the loan servicer responded to the application properly. When the lender accelerated the loan and scheduled it for foreclosure in 2015, Plaintiff filed a lawsuit. It alleged the Defendants violated RESPA by failing to comply with Section 1024.41(d). That regulation section requires that a servicer who denies a loss mitigation application must notify the applicant of the reason he was denied any trial or permanent loan application option available pursuant to the regulation.

Defendants denied the allegation that they had failed to comply with Section 1024.41(d). The unstated basis for the Answer's denial was that the loan servicer had complied Section 1024.41(i), which states: "A servicer is only required to comply with the requirements of this section for a single complete loss mitigation application for a borrower's mortgage loan account." The Court of Appeals ruled that the denial, without the detail, was sufficient, and affirmed the district court's determination that the Defendants were not required to plead Section 1024.41(i) as an affirmative defense.

The Court of Appeals also ruled that under Section 1024.41,which became effective January 10, 2014, "if the servicer complied with the requirements of the provision prior to the effective date, that compliance must be credited to the servicer because it need only comply with such a requirement once. *** The apparent purpose of the regulation is not to make already compliant servicers repeat their compliance actions, but rather to bring non-compliant servicers into compliance."

For more detail see Bank BCLP blog: https://bankbclp.com/2019/04/respa-is-a-shield-not-a-sword/

U.S. Supreme Court Holds That Arbitrators, Not Courts, Decide Arbitrability Under Contractual Delegations—Even When the Answer Is Obviously "No"

Henry Schein, Inc. v. Archer & White Sales, Inc. 139 S. Ct. 524 (SCOTUS, January 2019)

In January 2019, a unanimous Supreme Court tightened the grounds for avoiding contractual obligations to arbitrate in Henry Schein, Inc. v. Archer & White Sales, Inc. The Court's decision simultaneously reins in the ability of state and federal courts to limit the authority of arbitrators, while affirming the power of some arbitrators to determine their own jurisdiction under federal law.

Under the Federal Arbitration Act (FAA), courts must enforce contractual agreements to arbitrate as written. When faced with a potential dispute governed by the FAA, two questions immediately arise. First, do the parties' claims and allegations fall within the scope of their existing arbitration agreement? Second, who has the power to resolve any dispute over the answer to the first question: a judge or the arbitrator? Even when arbitration agreements clearly empower arbitrators to decide this second question of "arbitrability," some litigants nevertheless seek to dodge their contractual obligation to arbitrate by filing suit in state or federal court. These litigants then argue to courts that there was no need to involve an arbitrator, supposedly because it is "obvious" that the claims fall outside the scope of the agreement to arbitrate.

In Henry Schein, the Supreme Court resolved a conflict among the circuit courts by ruling that there is no such "wholly groundless" exception to the requirement that courts must enforce valid delegations of this authority

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to arbitrator. The "wholly groundless" exception, developed principally in the Fifth, Sixth and Federal Circuits, permitted courts to decide the second question of arbitrability as a threshold matter, even when parties had contractually delegated arbitrability to an arbitrator. The Supreme Court has now held that this judicially crafted exception is inconsistent with the FAA. The holding is in line with existing case law in the Third, Fourth, and Eleventh Circuits.

The plaintiff's complaint in Henry Schein had sought both damages and injunctive relief on the basis of state and federal antitrust laws. The arbitration clause applied to "any dispute" between the parties, but excluded claims for injunctive relief. After the plaintiff filed suit in federal court, the defendant moved to compel arbitration and argued that parties had incorporated the rules of the American Arbitration Association, which grants the arbitrator the power to resolve the threshold question of arbitrability. In lieu of compelling arbitration on this threshold issue, however, the district court and the Fifth Circuit held that the arbitration clause excluded the claim on its face because of the request for injunctive relief. Both Courts invoked the "wholly groundless" exception to determine that no arbitration was required to answer either question.

In vacating the judgment, the Supreme Court made clear that the proper analysis must begin by determining whether arbitrability is a question delegated to the arbitrator or reserved for the court. When parties have properly delegated the question to an arbitrator, that agreement must be respected and enforced, even if the court believes it is "obvious" that the parties' dispute falls outside the scope of their arbitration agreement. The Supreme Court dismissed various statutory and practical arguments that the FAA contemplated a threshold court review and rejected the notion that considerations of efficiency weighed in favor of adopting such an exception.

But, the Court's ruling applies only when the question of arbitrability is contractually committed to the jurisdiction of the arbitrator. If there is no such delegation, the court decides. Furthermore, when a party files suit to avoid arbitration, the court will still decide whether this power was delegated to the arbitrator in a "clear and unmistakable" fashion.

Relevant to this inquiry, the contract clause in Henry Schein required arbitration under the rules of the American Arbitration Association, which state that arbitrability is a question for the arbitrator. The Supreme Court specifically declined to address whether the contract, and by extension the American Arbitration Association rules, contained an enforceable delegation of that question to the arbitrator, since the Fifth Circuit did not reach that issue. Therefore, the Supreme Court remanded this issue to the lower courts. Other cases have held that the parties' explicit incorporation of the rules of a forum are a sufficient delegation to the arbitrator, see, e.g., Belnap v. Iasis Healthcare, 844 F. 3d 1272, 1284 (10th Cir. 2017), which may be the result on remand in this case.

In sum, Henry Schein makes clear that courts may not utilize a judicially crafted exception to guard

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their own power to decide arbitrability when a proper contractual delegation exists. For parties who wish to ensure that arbitrators exercise maximum control over future disputes, the Court's opinion reinforces the critical importance of drafting clear and explicit agreements to submit threshold question of arbitrability to an arbitrator. In the absence of such a delegation, courts retain full decision-making control over the question of arbitrability. If properly drafted, however, Henry Schein directs federal and state courts applying the FAA to honor these agreements in their entirety. Finally, although the Court's decision does not directly address issues related to the ability to pursue class actions in arbitration, the opinion serves as an expansion of the decision-making authority of arbitrators in lieu of courts.

Amendments proposed to HR1500 The Consumers First Act (sponsored by Rep. Maxine Waters)may roll back the 2017Congressional Review Act and re instate the CFPB's ban of consumer arbitration. For financial institutions that have arbitration agreements in place, this case may impact drafting and outcomes regarding arbitrability.

For more detail see BCLP Insights: https://www.bclplaw.com/en-US/thought-leadership/u-s-supreme-court-holds-that-arbitrators-not-courts-decide.html

2020 ISSUES TO WATCH

Regulator activity and rule makings could signal certain areas and drive potential consumer financial services class action risk. Here are a few items that may bear continued attention.

HUD Proposal Could Make it Harder to Bring Fair Housing Claims - Rule Makings

According to an early release by national media outlets, the Department of Housing and Urban Development ("HUD") has proposed an update to its "disparate impact" rule which would set a new standard for bringing disparate impact claims under the Fair Housing Act ("FHA"). The HUD disparate impact rule update would require plaintiffs to meet a five- step threshold to prove unintentional discrimination, bringing the claims process more in line with the Supreme Court's 2015 ruling in Texas Department of Housing and Community Affairs v. Inclusive Communities Project, 576 U.S. ___ (2015) ("Inclusive Communities") and codifying HUD's position that its rule does not impede on the states' regulation of insurance. Although the Court held that plaintiffs were only required to show that a policy had a discriminatory effect on a protected class, and not that the discrimination was intentional, it also required, among other things, that a plaintiff show through statistical evidence a "robust causal" connection between a discriminatory effect and the alleged facially neutral policy or practice.

The proposed new burden- shifting framework outlined in Section 100.500 of HUD's proposal includes five distinct elements:

Arbitrary and unnecessary. A plaintiff must plead that the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective. If a plaintiff meets these requirements, only then does the burden shift to the defendant to rebut the plaintiff and identify a valid interest in implementing the challenged policy.

Direct relationship. A plaintiff must allege a "robust causal" connection between the challenged policy or practice and a disparate impact on members of a protected class. Plainly stated, a plaintiff's analysis must show that the policy is the direct cause of the disparity.

Class-wide impact. A plaintiff must allege that the challenged policy or practice has an adverse effect on members of a protected class. It would be insufficient to allege only that the plaintiff is a member of a protected class and was adversely affected by the policy – the plaintiff must show that the disparate impact affects the group as a whole.

Materiality. A plaintiff must allege that the disparity caused by the policy or practice is significant. A disparity must be material. Merely alleging the existence of a disparity will be insufficient.

Causality. A plaintiff must allege that the disparate impact suffered by the plaintiff is proximately caused by the challenged policy or practice.

In drafting the proposed rule, HUD also acknowledged the growing use of algorithmic models to assess a consumer's creditworthiness, and provided defenses to allegations of disparate impact claims for the financial services institutions that employ these technologies.

A defendant may provide analysis to show that the model is not the actual cause of the disparate impact alleged by the plaintiff. A defendant may reverse- engineer the model to prove that each factor considered by the algorithm is not the cause of the disparate impact alleged by the plaintiff. A defendant may assert a claim that the algorithmic model is industry- standard, and that the model is being used for the industry- intended purpose. And a defendant also may prove through the use of a qualified expert witness that the model is not the cause of the disparate impact.

Link to Federal Register site here: https://www.federalregister.gov/documents/2019/08/19/2019-17542/huds-implementation-of-the-fair-housing-acts-disparate-impact-standard Comments closed in October 2019.

For more detail see Bank BCLP blog: https://www.bclplaw.com/en-US/thought-leadership/hud-proposalwould-make-it-harder-to-bring-fair-housing-claims.html

Use of Alternative Data in Underwriting Receives 'OK' from Federal Regulators -

December 2019 Interagency Banking Regulator Statement

In December 2019, U.S. federal banking regulators issued an interagency statement supporting the evaluation of alternative data when assessing consumers' creditworthiness. Recognizing that the use of alternative data may improve the speed and accuracy of credit decisions, the agencies hope to address the difficulty facing consumers who are often unable to obtain credit from traditional credit sources. According to FinRegLab, a nonprofit research organization, an estimated 45 million to 60 million consumers lack the credit history needed to generate satisfactory credit scores. Further, millions more do not have access to affordable credit due to low scores and low incomes. The use of alternative data in the rendering of credit decisions may improve credit opportunities, as firms may choose to use these alternatives for those applicants who would otherwise be denied credit.

One such data source is a borrower's cash flow as an alternative to the traditional credit- evaluation system. Although not an entirely novel concept, and an already well- established part of the underwriting process, some firms are now automating the use of cash flow data to determine a borrower's ability to repay loans. These newer automation methods have been found to improve the measurement of a borrower's income and expenses. Most importantly, the automation of a borrower's cash flow better illustrates income patterns over time from multiple sources as opposed to evaluating a single income source; the borrower information gleaned from these alternative sources is more robust and comprehensive than the information relied upon by traditional credit-evaluation companies. As the regulators highlight in their interagency statement, "cash flow data are specific to the borrowers and generally derived from reliable sources, such as bank account records, which may help ensure the data's accuracy."

To the extent firms are using or contemplating using alternative data, the agencies encourage responsible use of such consumer data. As the sources of alternative data grow, both banks and non- banks will need to determine which types of alternative data might carry more risk to consumers – and do their best to minimize or justify the use of such data sources. Although cash flow data provides a relatively unbiased predictor of loan repayment ability, some lenders have garnered fair lending scrutiny for their use of certain alternative data such as borrower occupation, education and information from social media. As the agencies made clear in their statement, lenders considering the use of alternative data must take steps to ensure consumer protection risks are "understood and addressed." Accordingly, it will remain vitally important for lenders leveraging alternative data to do so within a well- developed fair and responsible lending program that includes, among other things, periodic fair lending testing.

As the agencies gain a deeper understanding of alternative data usages, they may offer further information on the appropriate use of alternative data. Entities may choose to consult with appropriate regulators when planning for the use of alternative data.

OCC link here: https://www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-142a.pdf

See Bank BCLP blog: https://bankbclp.com/2019/12/use-ofalternative-data-in-underwriting-receives-ok-from-federalregulators/

OCC and FDIC Clarify the "Valid When Made" Debate – OCC FDIC Advanced Notice of Proposed Rulemaking November 2019

In November, the OCC and the FDIC issued Advanced Notices of Proposed Rulemaking (ANPRs) to clarify how state interest rate caps should apply when loans are sold across state lines.

The proposal from the OCC reaffirms the "valid when made" doctrine, on which many marketplace lenders have relied and which was central to the Second Circuit's 2015 decision in Madden v. Midland Funding LLC, 786 F.3d 246 (2nd Cir. 2015) (coining the term "Madden Glitch"). The Second Circuit's decision contradicted the "valid when made" theory, whereby an obligation is considered valid under the law that applied at the time of origination. The Second Circuit held that a loan's interest rate was no longer valid when resold to an entity in a state with a lower interest rate cap than where the loan was originally issued. In its proposed rule, the OCC "has concluded that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer." The OCC's proposed rule would cut against Madden, allowing the interest rates attached to bank loans to remain valid once transferred to a bank's fintech partner of investors.

The FDIC's proposed rule parallels that of the OCC, but focuses on Madden's relation to state-chartered banks. The FDIC's proposed rule clarifies that the legal interest rate on a loan originated by a state bank remains

legal even after the loan is sold to a non- bank. FDIC Chairwoman Jelena McWilliams said in a statement: "This proposed rule would correct the anomaly by establishing in regulations...that the permissibility of interest would be determined when a loan is made and is not impacted by subsequent assignment, sale, or transfer." The draft regulations issued by the FDIC affirm that state banks are not bound by the interest rate caps of other states in which they operate. Further, the validity of the loans' interest rates would be fixed at the time of origination.

Neither proposal addresses the issue of the "true lender" doctrine – whereby a court disregards the form of the lending configuration in favor of a searching examination of its substance, to determine which entity is the actual, rather than nominal, lender. Martin Gruenberg, former Chairman of the FDIC under the Obama Administration, criticized the FDIC's failure to recognize the "true lender" issue, arguing that the policy would lead to venue shopping and "rent-a-charter" agreements. Gruenberg believes that the FDIC's proposed policy would "effectively undermine an evaluation as to whether the bank is the actual or true lender of the loan and not a vehicle for a non- bank third party to benefit from state preemption."

Consumer advocates echoed sentiments similar to those highlighted by Gruenberg. Lauren Saunders, the associate director of the National Consumer Law Center, stated publicly that the "OCC proposal will encourage predatory lenders to try to use rent- a- bank schemes with rogue out- of- state banks to evade state laws that prohibit 160%loans." Other consumer advocates oppose the agencies' proposals, saying they could open the door to predatory lending practices and regulated protection of ill- intentioned actors.

Notwithstanding such concerns,marketplace lenders will welcome the certainty that such a "Madden fix" would bring to their industry. In the past, the Madden ruling created uncertainty for those interested in purchasing online lenders' loans; the OCC and FDIC proposals would work to remove that investor uncertainty. The OCC and FDIC both expressed concern that Madden reduces the value and liquidity of bank loan portfolios and negatively impacts safety and soundness. The comment period closed in January 2020.

For more detail see Bank BCLP blog: https://bankbclp.com/2019/11/occ-and-fdic-clarify-the-valid-when-madedebate/

FTC CLASS NOTICE STUDY

Class Notice Effectiveness – Some Surprising Results Concerning Email Notice

In September 2019, the Federal Trade Commission published a staff report concerning class action settlement campaigns, including the correlation between types of notice and claims rates. Analyzing data obtained from settlement administrators, the FTC found that the settlements within its study that used traditional,mailed notice packets had an average claims rate of approximately 10%. Postcard notices generated a claims rate of 6%, unless the postcard had a detachable claims form, in which case the claims rate was about the same as notice packets. Coming asa bit of a surprise, emailed notices generated a claims rate of only 3%. Email notices had the highest nondelivery rate of the multiple forms of notice (15%); only 17%of the delivered emails were opened; and only one out of every five recipients who opened an email notice clicked a link in the message. Electronic notice was added in 2018 to the Rule 23 class action procedure for methods of notice.

In a separate study testing how to make email notices more effective, the FTC found that a term like "refund" in the subject line made the email more likely to be opened but that including a specific dollar amount in the subject resulted in the email more likely to be interpreted as a solicitation and less likely to be opened. The FTC study tested various formats for the body of the message for recipient comprehension. The longform, text- heavy version of the notice performed best for comprehension and encouraging belief that the claims and refund process would work in the consumer's favor. Short- form notices were more likely to be viewed as a scam. Short and plain language wasmore effective, however, in conveying the required next steps.

The FTC studies are subject to various limitations based on the data and samples. The FTC sought public comment on the study and suggested that broad consumer education about the benefits of class action settlementsmay be needed. The FTC held a workshop in October 2019 to that end.

Practitioners should be aware of these findings (however caveated) in assessing and developing class notice programs, and of course the FTC and others may provide additional guidance going forward.

Link to FTC study here: https://www.ftc.gov/system/files/documents/reports/consumers-class-actions-retrospective-analysis-settlement-campaigns/class_action_fairness_report_0.pdf

OUR ATTORNEYS

MARK BRENNAN
Counsel
Class Actions
+1 816 391 7619
mwbrennan@bclplaw.com

JIM GOLDBERG
Counsel
Commercial Disputes
+1 415 675 3425
jim.goldberg@bclplaw.com

SAMANTHA GOLDBERG-SEDER
Associate
Banking
+1 415 675 3454
samantha.goldbergseder@bclplaw.com

ROSS HANDLER
Associate
Banking
+1 202 508 6103
ross.handler@bclplaw.com

JENNIFER JACKSON
Partner & Co-Leader
Commercial Disputes
+1 310 576 2360
jjackson@bclplaw.com

RODNEY PAGE
SeniorCounsel
Commercial Disputes
+1 202 508 6002
rfpage@bclplaw.com

MATT PETERSEN
Associate
Commercial Disputes
+1 303 866 0634
matt.petersen@bclplaw.com

JONATHAN POTTS
Associate
Class Actions
+1 314 259 2403
jonathan.potts@bclplaw.com

BENJAMIN SAUL
Partner
Banking
+1 202 508 6040
benjamin.saul@bclplaw.com

DOUGLAS THOMPSON
Partner & Banking
Sector Co-Leader
+1 310 576 2106
douglas.thompson@bclplaw.com

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