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U.S. APPEALS COURT RULES THAT MORTGAGE COMPANY WRONGFULLY IMPOSED LATE FEES BASED ON DELAY IN CREDITING PAYMENTS

The plaintiffs in this class action, *Fridman v. NYCB Mortgage Co., LLC*, alleged that the mortgage company's failure to credit online payments on the dates they were authorized by consumers violated the Truth-in-Lending Act (TILA). TILA requires a mortgage servicer generally to credit a payment to a consumer's loan account as of the "date of receipt."

Loan customers used the mortgage company's online payment system to authorize payments from their bank accounts. In particular, the customers would enter their bank routing and account numbers and authorize the mortgage company to withdraw funds from such accounts for the amount due on their mortgage loans. The mortgage company credited the electronic payments two business days after the payments were submitted by the loan customers. The mortgage company's rationale for the two-day delay was that this was the time it took to actually receive the funds through the ACH network from the customers' bank accounts. The plaintiff loan customers asserted that they were forced to pay late fees that they otherwise could have avoided if their online payments had been credited on the dates they were submitted, rather than two days later when the mortgage company had actually received the funds from their banks.

The Consumer Financial Protection Bureau's (CFPB) Official Interpretation to Regulation Z defines the "date of receipt" as "the date the payment instrument or other means of payment reaches the mortgage servicer." Although "payment instrument or other means of payment" is not defined in Regulation Z or CFPB interpretation, the court determined that the "other means" language called for a broad interpretation and pointed to other state law and the Dodd-Frank Wall Street Reform and Consumer Protection Act that define "payment instrument" to include electronic authorization. Accordingly, the court held that an online payment was received by the mortgage company, for purposes of TILA's crediting requirement, on the date the electronic authorization was submitted, not when the mortgage company actually received the funds.

The court noted that its decision promoted the protection of consumers against unwarranted delay by mortgage servicers. It's opinion states: "Nothing dictates when the servicer must deposit the check, use the payment information given over the phone to receive payment, or place the electronic authorization information in an ACH file to collect the fees…The servicer is in control of the timing, and without the directive to credit payment when it reaches the servicer, the servicer could decide to collect payment through a slower method in order to rack up late fees." Those collecting payments on mortgage loans may want to ensure that their procedures are in accord with this decision.

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VIRGINIA ATTORNEY GENERAL JOINS CONSUMER FINANCIAL PROTECTION BUREAU IN ENFORCEMENT ACTION TARGETING DEBT COLLECTION PRACTICES

The Attorneys General of Virginia and North Carolina recently joined forces with the Consumer Financial Protection Bureau in a lawsuit against Freedom Stores, Inc., Freedom Acceptance Corporation, Military Credit Services LLC, and the principals of these companies for "unfair and abusive practices" under provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). A consent order entered in the U.S. District Court for the Eastern District of Virginia in connection with the matter requires the defendants to provide over $2.5 million in relief to consumers and pay a civil penalty of $100,000 to the CFPB.

This is the first time that Virginia's Attorney General has used the consumer financial protection provisions of the Dodd-Frank Act to bring a civil action against a financial services firm.

Freedom Stores, Inc. is a Virginia-based furniture and electronics retailer that serves U.S. military members through its stores located near military bases across the nation. It finances sales to service members through retail installment sales contracts that it transfers to its affiliated company, Freedom Acceptance Corporation. Military Credit Services, which is owned by the same two principals who own the Freedom companies, also finances retail sales to service members.

The lawsuit alleged that these companies and their principals engaged in illegal debt collection activities. In particular, the defendants were charged with:

i. illegally filing thousands of lawsuits in Virginia against consumers based on a venue selection clause in the financing contracts when the consumers had not signed such contracts in Virginia and were not living in the state when the suits were filed;

ii. taking payments from consumers' bank accounts without their knowledge and before payment due dates, and "double dipping" by doing so even when payments were made via service members' military allotment (automatic deductions from their pay);

iii. contacting commanding officers to pressure service members into repayment; and

iv. illegally debiting the bank or credit card accounts of family and friends of service members.

Financial service providers should take particular note of the allegation that the venue selection clause was "unfair and abusive" under the Dodd-Frank Act. The clause designated the courts in Virginia as the venue for any disputes under the financing contracts.

The defendants routinely filed all their debt collection lawsuits in General District Court in Norfolk, Virginia rather than the judicial district where consumers lived or where they were physically present when they executed the financing contracts. The complaint alleged that consumers were unaware of the venue selection clause and had little opportunity to review the financing contract when it was signed, and, even if they had, they would have had no chance to bargain for its removal since it was a non-negotiable agreement. Based on this, the filing of debt collection lawsuits in Norfolk pursuant to such venue selection clause was "unfair," according to the complaint.

The complaint also alleged that the debt collection lawsuits were "abusive" under the Dodd-Frank Act because they allegedly took unreasonable advantage of consumers' inability to protect their interests by appearing in the venue. As a result, the lawsuits were almost certain to produce default judgments and lead to garnishments against consumers who were unable to appear in court and assert a defense. Financial firms should consider how they handle venue selection and debt collection lawsuits in light of this enforcement action.

RECENT U.S. SUPREME COURT CASES AFFECTING FINANCIAL SERVICES

Overtime Pay for Mortgage Loan Officers – In its March 9 decision in *Perez v. Mortgage Bankers Association*, the U.S. Supreme Court ruled that the Department of Labor (DOL) was not required to use notice-and-comment procedures in issuing interpretative rules, even when those rules made a fundamental change to earlier interpretative rules. The mortgage lending industry had sought to invalidate a 2010 DOL interpretation providing that mortgage loan originators who perform typical job duties do not qualify for the administrative exemption from the minimum wage and overtime pay requirements under the Fair Labor Standards Act. The 2010 DOL interpretation reversed a 2006 DOL interpretation that mortgage loan originators were in fact exempt. As a result of the court's decision, mortgage lending institutions are back to square one, and will need to evaluate practices and procedures regarding mortgage loan originator job classification and compensation to ensure compliance with the 2010 DOL interpretation.

Right of Rescission under the Truth in Lending Act – In its January 13 decision in *Jesinoski v. Countrywide Home Loans, Inc.*, the U.S. Supreme Court held that a borrower seeking to exercise his right to rescind a mortgage loan under TILA need merely give written notice of rescission to the creditor within three years of consummation, rather than filing a lawsuit within such period. TILA provides that in the event a lender fails to make certain required disclosures, a consumer has a right to rescind the loan within three years of the date the loan was consummated. The lender in the case argued that such right can be exercised by a borrower only by his filing a lawsuit. The Supreme Court rejected that argument, holding that written notice is all that is required under TILA.

Disparate Impact in Fair Lending – On October 2, 2014, the U.S. Supreme Court agreed to hear *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc*, a case in which the court will decide whether the disparate impact theory is valid under the Fair Housing Act (FHA). The court's decision will have ramifications under the Equal Credit Opportunity Act in addition to the FHA. The Consumer Financial Protection Bureau and the U.S. Department of Justice have relied on the disparate impact theory in fair lending enforcement against banks, mortgage companies and other lenders. Under such theory, discrimination may be shown even though an institution had no intention to discriminate. All that is required is a showing that an institution's practice had a disproportionately negative impact on a protected class, unless the institution's practice meets a legitimate business need that cannot be achieved as well by means that are less disparate in their impact. The court will decide whether disparate impact is a valid theory under the FHA. A finding that it is not would mean that the enforcement agencies could no longer use it as a fair lending enforcement tool.

Spousal Guarantors on Business Loans – On March 2, the U.S. Supreme Court agreed to hear *Hawkins v. Community Bank of Raymore*, a case in which the court will decide whether spousal guarantors can assert the Equal Credit Opportunity Act (ECOA) as a defense to a bank's collection efforts against such spouses. Under the facts of the case, two men obtained loans for their real estate development company from the bank totaling $2,000,000. In connection with the loans, the bank required personal guaranties from the wives of the two men. When the loans went into default and the bank sought to collect from the wives, the wives asserted a defense under ECOA. In particular, they alleged that the bank had required them to sign the guaranties solely because they were married to their respective husbands, which constituted discrimination based on marital status. The U.S. Supreme Court will resolve a split in opinion on the issue in lower court decisions.

CONSUMER FINANCIAL PROTECTION BUREAU PROPOSES FURTHER RELIEF TO “SMALL CREDITORS” UNDER MORTGAGE RULES

The Consumer Financial Protection Bureau has proposed a number of changes to the definition of “small creditor” under its mortgage rules. Community banks, credit unions, and other small lenders that qualify for small creditor status are entitled to a number of exemptions and exceptions under the mortgage rules.

In particular, under the CFPB’s Ability-to-Repay rules, balloon loans made by small creditors are eligible for Qualified Mortgage (QM) status even though balloon payments are otherwise not allowed with QMs. Also, mortgage loans held by small creditors in their portfolios are eligible for QM status even if the debt-to-income ratio exceeds the 43% limit that would otherwise apply. Moreover, the requirement to establish an escrow account for first-lien loans exceeding the average prime offer rate by 1.5% on first-lien mortgage loans, and 2.5% on subordinate-lien mortgage loans, does not apply to small creditors operating predominantly in rural or underserved areas. Finally, under the CFPB’s Home Ownership and Equity Protection Act rules, small creditors operating predominantly in rural or underserved areas can originate high-cost mortgage loans with balloon payments.

Under the current mortgage rules, “small creditor” is defined to generally mean a creditor with no more than $2 billion in assets that (along with its affiliates) originates no more than 500 first-lien mortgages per year. CFPB’s proposed changes would:

i. Raise the loan origination limit for small creditor status from 500 first-lien mortgage loans to 2,000 mortgage loans and exclude loans held in portfolio by the creditor and its affiliates from the limit;

ii. Include assets of the creditor’s mortgage-originating affiliates in calculating whether a creditor is under the $2 billion asset limit;

iii. Expand the definition of “rural” to include census blocks that are not in an urban area, as defined by the Census Bureau;

iv. Extend the period of the temporary exemption under the QM rules for balloon mortgages made by small creditors, regardless of where they operate, from January 16, 2016 to April 1, 2016 (applications received before that date would be exempt); and

v. Make other technical changes intended to help small creditors.

The proposal is subject to a comment period which ends March 31.

IDENTITY THEFT PROTECTION PROGRAMS OFFER OPPORTUNITY FOR COMMUNITY BANKS

With identity theft increasingly on the minds of consumers, an identity theft protection program is a natural fit for community banks to offer their customers. It’s an attractive bank product to help address consumer concerns, and it’s a good source of fee income.

But bankers should take care that any third-party vendor used to offer the product is fully vetted and that regulatory issues are fully addressed. The banking regulators have been concerned about the way financial institutions offer add-on products, such as identity theft programs, and have brought a number of enforcement actions against larger institutions concerning add-on products offered in connection with credit cards. Those violations have related to: promotional practices, including how terms and conditions are disclosed; how the consumer’s consent is obtained in connection with the product; and billing practices. Tending to an effective review of a proposed vendor and all compliance-related issues on the front-end can minimize the likelihood of any problems with regulators or consumers after the product is launched.

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