STARNES DAVIS FLORIE LLP

BANKING & FINANCIAL SERVICES NEWSLETTER

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

ACCOUNT TRANSACTIONS

The UCC displaces common law claims in Alabama even in the absence of a specifically applicable provision.

Alabama is one of a number of states recognizing that common law claims can be displaced by provisions of the Uniform Commercial Code ("UCC"). This has been recently expanded to affirm that common law claims can be displaced where inconsistent with UCC remedies and defenses, even where there is no specific UCC provision applicable to the claim. The Supreme Court of Alabama, in addressing the claims of a drawer of over 200 unauthorized checks seeking recovery from a depository bank, concluded that the common law claims could not be maintained because they would allow a right of recourse not contemplated by and inconsistent with the UCC.

Braden Furniture Co., Inc. v. Union State Bank, ___ So.3d ___, 2012 WL 5077221 (Ala. Oct. 19, 2012).

Unilateral changes to account agreements can be enforced upon proof of notice to the account holder.

Most depository account agreements state that the agreement can be unilaterally amended by sending notice of the new provisions to the account holder. This notice, coupled with the holder's continued use of the account, is generally held to be sufficient to amend effectively an account agreement.

However, when seeking to rely on the amended portions of an account agreement in order to compel arbitration based upon a new arbitration provision, affidavits in support of such an effort must include a description of how the customer was notified of the amended provisions in order to enforce them. This becomes more difficult when bank mergers have created a series of varying account agreements.

Wells Fargo Bank, N.A. v. Chapman, 90 So. 3d 774 (Ala. Civ. App. 2012).

An account agreement may shorten the time period for reporting unauthorized account transactions under the UCC.

The UCC provides that a customer has a strict 180 day period within which to report suspected unauthorized transactions on his or her account. Otherwise, the account holder is precluded from obtaining reimbursement by the bank. *See* Ala. Code § 7-4-406. However, a customer agreement that contains a provision which shortens the 180 day time period, even to 30 days, *is enforceable*, as recently affirmed by the Alabama Court of Civil Appeals.

Absolute Drug Detection Services, Inc. v. Regions Bank, ___ So.3d ___, 2012 WL 6634430 (Ala. Civ. App. 2012).

Bank can avoid liability for fraudulent wire transfer when it offers commercially reasonable security procedure.

While, as a general rule, the risk of loss for unauthorized wire transfers lies with the financial institution, one bank was recently successful in avoiding a loss following a fraudulent wire transfer of over $400,000 through an internet wire transfer system by an unknown third party.

Because the bank had established a security procedure which was a commercially reasonable method involving “dual controls” (two persons required to authorize the release) and the customer elected to decline the procedure and waive its usage in writing, the U.S. District Court of Missouri found that the bank was not liable under the applicable provisions of Article 4A of the UCC.

The court also found that the bank had acted in good faith in processing the wire transfer request. This case emphasizes the tension that often exists between security and convenience. Because the customer opted for the most convenient method for transfer approval, the risk shifted, as it should, to the customer.

Choice Escrow and Land Title LLC v. BancorpSouth Bank, 2013 WL 1121339 (W.D. Mo. 2013).

Class action waivers incorporated into arbitration agreements are enforceable in the 11th Circuit.

The Supreme Court of the United States, in its decision in *AT&T Mobility LLC v. Concepcion*, 1315 S.Ct. 1740 (2011), held that most state-law attempts to ban class action waivers in consumer arbitration provisions were preempted by the Federal Arbitration Act (“FAA”). Since this decision, several circuits, including the Eleventh, have affirmed the enforcement of class action waivers.

In the Eleventh Circuit case, a wireless telephone customer brought a putative class action against its wireless service provider, alleging the service provider charged improper roaming fees. The U.S. District Court for the Southern District of Florida granted the service provider’s motion to compel arbitration and dismissed the class action. The 11th Circuit Court of Appeals affirmed, citing to *Concepcion*, and stated that resolution of the appeal required “only a straightforward application of *Concepcion* …” *Id.* at 1234. This application resulted in the conclusion that a class action waiver and arbitration clause in a wireless telephone contract is to be enforced according to its terms.

Pendergrast v. Sprint Nextel Corp, 691 F. 3d 1224 (11th Cir. 2012).

Can the Dodd-Frank Anti-Arbitration Provisions withstand the Scrutiny of the Supreme Court of the United States?

Justice Scalia's majority opinion in *Compucredit Corp v. Greenwood,* 132 S.Ct. 665 (2012), which was an action brought under the Credit Repair Organizations Act ("CROA"), concluded forcefully that absent an express "command" from Congress to deny arbitration rights under the FAA, no preclusion of those rights can occur.

This decision found that a right to sue did not require a suit in court, and, therefore, the CROA did not contain a "clear command" overriding the rights secured under the FAA, which established a "liberal federal policy favoring arbitration." Thus, the Court held that the arbitration provision in the subject credit card application was to be enforced according to its terms.

This opinion necessarily raises a question regarding how it may affect the Consumer Financial Protection Bureau ("CFPB") regulations that will follow the Dodd-Frank statutorily-mandated study of the "fairness" of pre-dispute arbitration agreements in the context of consumer protection statutes. Section 1028, 12 U.S.C. § 5518.

While the Dodd-Frank legislation already specifically outlaws arbitration provisions for residential mortgage loans and HELOC's, the mandated study and regulations to follow regarding the enforceability of arbitration clauses in other consumer transactions will likely raise the issue of whether Congress has issued through Dodd-Frank a clear "contrary command" sufficient to override the FAA. Certainly, the likelihood of litigation regarding these anticipated regulatory restrictions is great.

RECOVERY – COLLECTIONS & FORECLOSURE

Foreclosure Rights

The issue of standing for foreclosure of a mortgage loan has certainly become a national issue due to the controversies involving "robosigners." The courts in Alabama have also recently addressed the standing issue in the context of ejectment actions following non-judicial foreclosure allowed in this state.

In these cases, the borrower's defense was that the note and mortgage were improperly separated from one another. The Alabama courts have repeatedly rejected that argument, noting that the Alabama Code specifically allows for the separation of a mortgage from a note. When that separation occurs, the court likened the relationship between note and mortgage to that of a cow and its tail: "The note is the cow and the mortgage the tail. The cow can survive without a tail, but the tail cannot survive without the cow." Therefore, the note is the critical instrument and the holder of the note holds the right to the collateral. Thus, a second issue must be determined: who held the note when the foreclosure was initiated?

Recent cases have reiterated the traditional application of Alabama's UCC to answer this question. These cases recognize and reaffirm what has long been the rule in Alabama: that the holder of the obligation can enforce the security interest, irrespective of the mortgage assignment. Thus, the assignment has been deemed as "superfluous" based on the lender's status as a holder under the UCC.

Of course, timing of the rights acquired under the UCC remains a critical issue, but the UCC provides more flexibility. Where foreclosing lenders may still rely on the chain of title established by the public records, the UCC confers rights as a holder based on allonges, possession, transfer, and negotiation. With the ubiquity of transferring and pooling of notes and mortgages, the recorded assignment of mortgage, though still recommended, is not critical to the determination of the foreclosing entity's standing.

Coleman v. BAC Servicing, __ So. 3d __, 2012 WL 2362617 (Ala. Civ. App. June 22, 2012); *Perry v. Federal National Mortgage Association*, 100 So. 3d 1090 (Ala. Civ. App. 2012); *Thomas v. Wells Fargo Bank, N.A.*, __ So. 3d __, 2012 WL 3764729 (Ala. Civ. App. Aug. 31, 2012) (recent cases affirming rights of note holder).

MORTGAGE BACKED SECURITIES

Activity continues in class action and individual litigation involving mortgage backed securities which have claimed that subprime lenders and others who sold the trusts misled investors by disregarding underwriting guidelines and approving mortgage loans despite deficiencies. The U.S. Court of Appeals for the Second Circuit recently reinstated a class action dismissed by the U.S. District Court in Manhattan.

New Jersey Carpenters Health Fund v. The Royal Bank of Scotland Group, PLC, et al., 709 F.3d 109 (2d Cir 2013).

Goldman Sachs has also appealed a case to the Supreme Court of the U.S. after the U.S. Circuit Court of Appeals for the Second Circuit permitted a pension fund for electrical workers to sue it for misleading investors in the sale of such securities.

Goldman Sachs & Co., et al. v. NECA-IBEW Health & Welfare Fund, U.S. Supreme Ct. No. 12-528 appealing decision in N*ECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012).

Bank of America's Merrill Lynch Mortgage Lending, Inc. has also been recently sued by a trust seeking more than $309 million in damages based on the sale of more than 5,000 mortgage loans which had been securitized and sold. The Merrill Lynch unit had allegedly failed to buy back the loans based on the allegations of misrepresentation and breach of warranty due to their delinquency.

MGRID LLC v. Merrill Lynch Mortgage Lending, Inc., 651140/2013 (N.Y. Sup. Ct. 2013).

THE DODD-FRANK ACT & CONSUMER FINANCIAL PROTECTION BUREAU

Mortgage Lending

As has been widely publicized since the enactment of the Dodd-Frank legislation, the CFPB issued significant final regulations in the first quarter of 2013, which will take effect in January 2014, impacting residential mortgage lending.

Ability to Repay

While rules of the Federal Reserve Board have previously been in effect prohibiting creditors from making "higher priced mortgage loans" without assessing the borrower's "ability to repay," the recently adopted CFPB rules for "ability to repay" and a presumption of compliance for "qualified mortgages" extend, with few exceptions, to the entire mortgage market. 12 C.F.R. Part 1026, 78 F.R. 6407 (Jan. 30, 2013). The CFPB, as a part of its proposed expansion of exemptions and qualifications for the rules, has also added another category to the three outlined for qualified mortgages, which includes those originated by small lenders. *Id.* These final rules set forth minimum requirements for underwriting loans and encourage refinancing of "non-standard" mortgage loans prevalent in the subprime wave. The "Qualified Mortgage" ("QM") presumption is of concern for subprime loans due to the risk of the borrower's claim that they failed to satisfy the requirements of the QM.

These rules have generated over 900 detailed comments from community banks, brokers and state associations, among others, opposing various aspects of the rules, including concerns regarding the limitations on balloon loan features and the APR threshold. Concerns have also been raised about the limiting definition of "rural" adopted by the CFPB. Other comments have included objections to the inclusion of loan origination compensation in points and fees calculations as unduly restricting credit and fostering unfair competition.

These rules further raise concerns that by making only QM's which can be proven if challenged, the lender could be exposed to claims of disparate impact by not engaging in fair lending practices resulting in violations of the Fair Housing Act or the ECOA. While lenders are encouraged to make QM loans which will survive scrutiny, there is no certainty that such a practice will not be challenged as discriminatory and a violation of fair lending.

The CFPB has recently issued a compliance guide for small banks and mortgage lenders to better understand the "qualified mortgage" rule. The guide can be obtained at the bureau's website, http://www.consumerfinance.gov.

Servicing

As to the newly pronounced servicing rules, which will also take effect in January 2014, the focus is on a number of major topics, including: providing periodic statements for each billing cycle, advanced notices prior to interest rate adjustments, prompt credits for payments, providing of payoff balances, strict rules on forced placed insurance, prompt responses to requests for information or complaints of error, early intervention and continuity of contacts with delinquent borrowers, and required loss mitigation procedures, including loan modification programs, for consideration prior to foreclosure and delinquency of at least 120 days.

While there are certain exemptions for small servicers, these new rules have resulted in a wave of servicers moving toward exiting the business or outsourcing to third parties. With the increase in servicing transfers, the CFPB has issued a Bulletin to emphasize its focus on the negative impacts on borrowers which can result from such transfers. CFPB Bulletin No. 2013-01 (Feb. 13, 2013).

Mortgage Insurance

The CFPB recently announced enforcement action including the assessment of $15 million in penalties against certain national mortgage insurance companies due to the practice of proving alleged kickbacks to mortgage lenders through the purchase of captive reinsurance. It is anticipated that additional actions will be taken against the lenders involved based on claims of violations of the Real Estate Settlement Procedures Act. The CFPB concluded that these practices necessarily increased the costs to consumers.

CFPB Complaint Database

Another CFPB process of continuing concern is the recent expansion of the scope of the Bureau's publicly accessible consumer complaint database beyond credit card issues to include complaints about mortgages, bank deposits, loan servicing, student loans and other consumer loans at the larger banks. CFPB Press Release, Mar. 28, 2013.

While this expansion may encourage the faster resolution of these complaints, the database of information and allegations made against these larger financial institutions is not fully verified and, thus, could be inaccurate and potentially damaging. Moreover, this data is being made available to many seeking to use it to their advantage which, obviously, poses new litigation risks.

The question also remains as to whether the other regulatory agencies which regulate the smaller institutions will take the CFPB lead and institute expanded customer complaint databases with information which has not been fully verified.

Indirect Auto Lending

CFPB has also recently given notice of its focus on indirect auto lending and the potential for pricing disparities created by dealer markups in interest rates or increase in dealer compensation through markups. The CFPB maintains that this creates a risk of practices which violate the fair lending requirements of the ECOA with liability under the legal doctrines of both disparate treatment and disparate impact. Thus, the CFPB has given notice by bulletin of its intent to closely review the operations of both depository and non-depository lenders. CFPB Bulletin No. 2013-02 (March 21, 2013).

ATM Fee Disclosure

In a more positive development for financial institutions involved in ATM banking, the CFPB issued final regulations on March 26, 2013, affirming the December 2012 amendments to the Electronics Fund Transfer Act ("EFTA") eliminating the requirement that an ATM machine have a fee disclosure notice posted on or at the machine in addition to the disclosure provided-on screen or on paper which provides the fee to be charged before the consumer commits to the transaction. The prior requirement generated a number of class actions against small and large banks, most of which were frivolous and of no real benefit to consumers, and resulted in added costs for ATM operators.

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