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Banking & Finance: Regulatory and Case Law Update

August 4, 2022

2022 Summer Webinar Series

Continuing Legal Education

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Disclaimer: This presentation is designed and intended for general information purposes only and is not intended, nor should it be construed or relied on, as legal advice. Please consult your attorney if specific legal information is desired.

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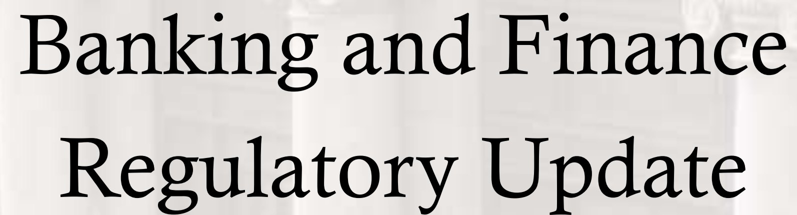

Presenters: Lynn Hartman & Stephen Larson

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Interagency Task Force on Property Appraisal and Valuation Equity (PAVE)

Pave Member Agencies:

- U.S. Department of Housing and Urban Development
- White House Domestic Policy Council
- Appraisal Subcommittee
- Federal Reserve Board
- Consumer Financial Protection Bureau
- Federal Deposit Insurance Corporation
- Federal Housing Finance Agency
- National Credit Union Administration
- Comptroller of the Currency
- U.S. Department of Agriculture
- U.S. Department of Justice
- U.S. Department of Labor
- U.S. Department of Veterans Affairs

PAVE Action Plan (March 22, 2022)

Goal: Eliminate racial bias in the home lending and appraisal process

Legal Basis: Fair Housing Act ("FHA"), Equal Credit Opportunity Act ("ECOA"), and other federal, state, and local anti-discrimination laws.

- https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf

PAVE- Certain Proposed Reforms

- Develop guidance, policies, and rules for lending institutions and third party anti-discrimination obligations under the FHA and ECOA.
- Increase regulatory agency monitoring, data collection, and enforcement powers.
- Address the potential bias of Automated Valuation Models ("AVMs")
- Expand use of alternative appraisal models (other than sales comparison method)

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Tate-Austin v. Miller (United States District Court, Northern District of California, 2022)

A Black couple sought to refinance their home mortgage. A licensed appraiser visited their home and determined a value of $995,000. A few weeks later, another appraiser visited their home while a white friend posed as the homeowner. The second appraiser set the home's value at $1,482,500.

Plaintiffs allege consideration of race motivated the first appraiser's lower valuation, in violation of federal and state law, including the Fair Housing Act.

The DOJ has filed a statement of interest in the case, outlining how appraisal discrimination claims can be made under the FHA.

Lender Takeaways from PAVE Action Plan

- Expect the need to develop/update anti-discrimination policies for the appraisal and home lending process.

- Expect the need for computerized appraisal models be evaluated for compliance with future anti-discrimination rules and regulations.

- Expect the need for greater review of third-party contractors.

Community Reinvestment Act (“CRA”) & Related Developments

DOJ’s Combatting Redlining Initiative

- Redlining: “avoid providing services to individuals living in communities of color because of the race or national origin of the people who live in those communities.”

- DOJ is assessing LAR data in industry-wide sweeps and assessing it for potential redlining, particularly in CRA assessment areas.

Community Reinvestment Act ("CRA") & Related Developments

HUD Discriminatory Effects/Disparate Impact Rule

- 2013 rule, proposed for reinstatement.
- "Discriminatory Effect": Discrimination can be established by evidence of facially neutral practices that have an unjustified discriminatory effect (in contrast to requiring a showing of intent to discriminate)
- Important to re-evaluate CRA compliance.

CFPB & Junk Fees

Consumer Financial Protection Bureau ("CFPB") is seeking to curb so-called "junk fees" charged by banks and other lending institution.

CFPB & Junk Fees

CFPB definition of "junk fees":

"[M]andatory or quasi-mandatory fees added at some point in the transaction after a consumer has chosen the product or service based on a front-end price….[similar to]…."resort fees added to hotel bills and service fees added to concert ticket prices."

Junk Fees

CFPB Examples of junk fees:

"Penalty fees such as late fees, overdraft fees, non-sufficient funds (NSF) fees, convenience fees for processing payments, minimum balance fees … and more."

Junk Fees

CFPB requested comments through April 11, 2022.

Lenders should be prepared to evaluate and adjust their fee structures if the CFPB issues new rules.

However, this may only be the CFPB making a policy statement.

CFPB Bulletin re: Auto Repossession

- COVID-19 has led to extremely strong demand for used automobiles.
- CFPB concerned about increased lender incentives for risky automobile repossession practices.
- Legal Framework: Unfair or Deceptive Practices under the Dodd-Frank Act.

Examples of Unfair or Deceptive Practices That May Lead to Consumer Default and Repossession

- Applying payments in a different order than disclosed to the borrower.
- Charging unnecessary or duplicative insurance fees.
- Refusing to return personal property contained in a vehicle until payment of fee.
- Failing to honor options presented to delinquent borrowers to avoid repossession.

In the Matter of Nissan Motor Acceptance Corp. (Oct. 13, 2020)

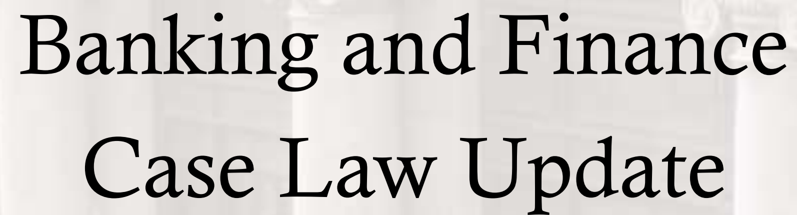
Facts: A loan servicer told borrowers that it would not repossess vehicles if their loans were 60 days past due or if they entered into an agreement to extend the loan or if they promised to make a payment by a specific date.

In the Matter of Nissan Motor Acceptance Corp. (Oct. 13, 2020)

Holding: The CFPB found the loan servicers wrongfully repossessed vehicles of consumers who had:

- Made and kept promises to pay and brought the account current;
- Made payments that decreased the delinquency to less than 60 days past due;
- Made promises to pay where the date had not passed; or
- Agreed to extension agreements.

Prior to an auto repossession, lenders should ensure they are only charging legally authorized fees and acting consistently with any communications made to delinquent borrowers.



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Dragnet Clauses Should Have Unambiguous Language

- *Sanborn Savings Bank v. Freed*, 38 F.4th 67 (8th Cir. 2022)
    - **Wife and husband** executed a mortgage with a future advances/dragnet clause (and homestead waiver) to secure note to purchase a condominium. Years after, **husband individually** took out business notes.
    - Condo was later sold in husband's bankruptcy case, with proceeds paying off the condominium note **but not** the business notes. The couple divorced—wife's share of proceeds placed in escrow.
    - Court held **wife's share** of condo proceeds was subject to husband's business note debt under the "unambiguous language" of the future advances/dragnet clause
- Use clear, unambiguous language and **BOLD HEADERS** to ensure future advances/dragnet clause secures all debts

Interest Rate for Foreclosure Redemption

- *Mlady v. Dougan*, 967 N.W.2d 328 (Iowa 2021)
  - Dougan was assigned mortgagor's right of redemption. She deposited enough to redeem at the note's non-default interest rate, but not at the default interest rate
  - Mlady, the purchaser at the sheriff's sale, argued that the default interest rate applied because the mortgagor was in default on the mortgage.
  - The court agreed, holding that the terms of the note determine the rate of interest and that, under the note at issue, the mortgagor had opportunity to cure his default and revert to the non-default rate
- The language in the loan documents will control the interest rate that a mortgagor must redeem at. Check the language!

Foreclosure Redemption Mechanics

- *Mlady v. Dougan*, 967 N.W.2d 328 (Iowa 2021)—again!
  - After Dougan made first deposit at non-default rate, she made a second deposit at the default rate
  - But the second deposit was also short by a small amount, so she made a third deposit after the redemption period expired
  - Dougan argued the deposits decreased the per diem interest accruing on the outstanding amount and that the belated redemption was effective for reasons of equity
  - The court held despite the deposits interest accrues on the **entire amount** of the outstanding balance and that equity did not favor extending the redemption period
- All of the amount owed on the debt must be paid within the redemption period unless the late payment can be attributed to the court

Equitable Mootness

- *Fishdish v. Veroblue Farms USA, Inc.*, 6 F.4th 880 (8th Cir. 2021)
  - Chapter 11 plan of reorganization was confirmed. A shareholder of the debtor appealed, but did not seek a stay. Plan distributions were commenced, pre-confirmation shares in the debtor were cancelled, post-confirmation trust sued for preferences and made deals—aka lots happened
  - Appellees moved to dismiss appeal as "equitably moot." District Court did so.
  - Eighth Circuit reversed and remanded. It did not adopt a test, but noted that the plan's **substantial confirmation** and the **effects of the plan's reversal on third parties** were the most important factors. **Preliminary review of the merits** was also required!
- Equitable mootness is disfavored in the Eighth Circuit

Priority of Liens: Subcontractor Mechanics Lien v. Mortgage

- *Borst Bros. Constr., Inc., v. Fin. Am. Com.*, 2022 WL 2182391 (Iowa March 24, 2022)
  - Owner-Builder did not register commencement of work within 10 days. Two subcontractors posted notice within 90 days after completing work. Lender recorded mortgages after work commenced, but before either subcontractors' notice.
  - Court held that subcontractors' mechanics lien was superior to Lender's recorded mortgages because each commenced work prior to Lender's recording of its mortgages.
- Consider requiring your borrower (a) bond the project, (b) make joint check or escrow arraignments, or (c) require subcontractors waive or subordinate their lien rights.

Foreclosure Action Parties

- *Bayview Loan Servicing LLC v. Fogarty (In re Fogarty)*, 2022 WL 2443388 (2d. Cir. July 6, 2022)
  - Eileen Fogarty held a 99% interest in an LLC that owned the home that she lived in; LLC defaulted on the loan
  - Foreclosure action filed against the LLC, also naming Fogarty as a defendant (interested party with possessory interest)
  - 4 days before property sale, Fogarty filed bankruptcy, then asserted automatic stay under Section 362; sale went through
- Court held that the sale violated the automatic stay solely because the debtor was a named party in the foreclosure action; the impact on her bankruptcy estate was irrelevant

Junior Lienholder Accepting Payment a Conversion?

- *Agrifund v. Heartland Coop.*, 8 F.4th 660 (8th 2021)
  - Two lenders entered into a subordination agreement. Junior lender accepted payment from borrower without confirming Senior lender had been paid in full. Senior lender sued for conversion.
  - Court held that Junior lender was liable for conversion because it failed to "exercise reasonable commercial standards of fair dealing" when it didn't take minimum effort to confirm Senior lender "had been fully recompensed before accepting the payment. . . ."
- Confirm Senior liens have been paid before accepting payment
- To incorporate the terms of a note into Subordination Agreement, language must explicitly do so

Pre-petition Judicial Disclosure Nondischargeable

- *In re Reed*, 2022 WL 2156662 (9th Cir. May 16, 2022)
  - Creditor had a Judgment of Foreclosure and Order of Sale. Debtor filed for chapter 7 discharge, after labeling the judgement an "unsecured nonpriority" levy or money judgement. Debtor sought to have Creditor held in contempt for its continued pursuit of payment after discharge.
  - Court held that bankruptcy discharge has no effect on pre-petition foreclosure judgements because the foreclosure and order of sale was *in rem* and not a "personal liability" of Debtor.
- Evaluate the nature of claims to determine whether pursuit after discharge remains possible.

COVID 19 is not Commercial Frustration or Economic Harm

- *Acentium Cap. v. Littell*, 2022 WL 301685 (W.D. Mo. Feb. 1, 2022)
  - Debtor conceded breach of several loan documents, but argued the agreements were not enforceable because COVID 19 was a commercial frustration making performance impracticable or impossible.
  - Court held that COVID 19 was not sufficient to show commercial frustration or economic harm and granted Summary judgement in favor of the Secured Creditor
- Debtors may struggle to prove commercial frustration due to COVID. Creditors in Iowa should take precautions in case Iowa Courts do not follow this ruling.

Claim for Funds Advanced on Letter of Credit

- *In re Spiegel*, 638 B.R. 324 (Bankr. N.D. Ill. 2022)
  - Bank honored beneficiary's request to draw on letter of credit. After filing chapter 11, Debtor objected to Bank's proof of claim for the advanced funds.
  - Court held that bank was not required to strictly comply with Letter of Credit to determine whether or not to honor it, but could instead make a reasonable decision based on uniform customs and practice.
- Although the court sided with the Bank's proof of claim here, creditors should exercise caution when honoring Letter of Credit requests.

Vehicle Leases

- *In re East Shore Auto, Inc.*, 638 B.R. 324 (Bankr. M.D. Penn. 2022)
  - Debtor owned a dealership where it regularly purchased vehicles on credit, leased the vehicles to consumers, and sold the title and leases to an Auto Company. Debtor did not use proceeds from the sale to pay off Creditor. Secured Creditor claimed it was entitled to the monthly lease proceeds earned by Auto Company and refused to release its lien on the titles.
  - Court held that Auto Company was a "good faith purchaser in ordinary course of business" and creditor had no claim against Auto Company.
- Consider requiring Debtor's assign leases and restrict transfers of title and leases to third parties. Inspection of premises to ensure inventory on lot and recording lien on title may be insufficient to protect creditor's interests.

Commercial Tort Claims and Security Agreements

- *In re S-Tek*, 635 B.R. 860 (Bankr. D. N.M. 2021)
  - Secured Creditor sought interest in Debtor's commercial tort claim, or the proceeds from it, under N.M. Art 9, UCC, arguing the claim/proceeds were either a "general intangible" or "after acquired general intangible"
  - Court held that Creditor did not have secured interest in any tort claims because "[t]he grant of a security interest in a commercial tort claim must be described with particularity."
- Consider amending Security Agreements and UCC-1 filings to include specifics for any known tort claims.

Nondischargeable Loan Debt

- *In re Stum*, 2021 WL 5630342 (10th Cir. B.A.P, Dec. 1, 2021)
  - Debtor disclosed debts to third-parties but not debts to his family corporation when applying for loans
  - Court held that debtor materially misstated his liabilities and intended to deceive the lender, rendering the loans non-dischargeable in bankruptcy
- If closely held corporate shares are a substantial portion of a client's net worth, consider requesting financial statements for risk rating even if the shares are not collateral for the loan

Revocable Trust as Guarantor

- *JPMorgan Chase Bank, N.A. v. Winget*, 2022 WL 2389287 (6th Cir. July 1, 2022)
  - Larry Winget guaranteed a loan both in his individual capacity (up to $50 million) and as a representative of his living trust (unlimited, now $750 million)
  - After default, paid the individual guaranty but revoked his living trust; claimed that the trust (as guarantor) owned no assets, and that Larry (as settlor and sole beneficiary) actually owned the property
  - Court held that the revocation was a constructively fraudulent transfer
- Be careful with revocable trusts as guarantors; dissent in this case disagreed that the revocation was a transfer; agreed with Larry that the revocable trust itself never owned any assets

Overpayments

- *Tuggle v. Wells Fargo, N.A.*, 2021 WL 6804071 (S.D. Iowa Sept. 9, 2021)
  - Mortgagor claimed that Wells Fargo continued collecting MIP payments beyond the specified period and delayed notifying him of the overpayments
  - On Wells Fargo's Motion to Dismiss, Iowa Consumer Credit Code (threshold amount exceeded) and California Unfair Competition Law statutory claims were dismissed
- Tort claims, including fraud (superior knowledge), breach of contract, conversion, and negligence survived the Motion to Dismiss, requiring discovery

Fraudulent Transaction Liability

- *Muff v. Wells Fargo Bank, N.A.*, 2022 WL 1687115 (N.D. Iowa May 2, 2022)
  - Bank account holders stepson convicted of theft from plaintiff's account, including fraudulently endorsed checks
  - Account closed, then plaintiff died in 2018
  - Earlier order: Iowa law does not recognize a private cause of action against a bank for failing to prevent elder exploitation by a third party (the stepson)
- Court granted Wells Fargo's motion for summary judgment on conversion claim because no investigation of transactions requested; also time barred by account agreement (30 days to report) and 3 year UCC Article 4 statute of limitations (Iowa Code 554.4111)

Debt Acceleration

- *GreenState Credit Union v. Property Hollers, Ltd.*, 2022 WL 20154816 (Iowa Ct. App. June 15, 2022)
  - GreenState accelerated debt on 8 promissory notes; after foreclosure actions mortgagor continued to make periodic payments, then claimed that GreenState's acceptance of the payments waived any right to accelerate
  - Court held that post-acceleration payments only served to reduce the total balance owed and did not constitute a waiver by GreenState
  - Attorney fees awarded to GreenState under Iowa Code 625.22

Statute of Limitations- Series of Judgements

- *Rosenbaum v. Kerndt Brothers Savings Bank*, 2021 WL 4304968 (Iowa Ct. App. Sept. 22, 2021)
  - Court previously affirmed denial of borrowers' appeal to set aside a sheriff's sale of their property
  - Here, borrowers appealed dismissal of their petition to set aside a series of five judgements for failing to comply with the one-year statute of limitations under Iowa R. Civ. P. 1.1013
- Court affirmed, holding that the one-year limitations period ran from the entry of each judgment, meaning that the most recent of the judgements could not save the earlier in the "series" that exceeded the one-year period

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