BY ALEXANDER HENDERSON, III, ESQUIRE

RECENT LITIGATION ACTIVITY and federal court decisions reinforce the imperative for financial institution executives to maintain oversight of front line compliance practices and procedures. While in some cases the courts have made it more difficult for class actions to be certified against financial institutions, the U.S. Supreme Court is poised to consider a case which may open the field for consumer class action lawsuits against financial institutions for statutory violations—without proof of actual damages to the consumer.

No matter what the decision of the U.S. Supreme Court regarding the requirement of actual damages, regulators will continue to cooperate with a very active Consumer Financial Protection Bureau ("CFPB"). The CFPB is commencing litigation and obtaining success in the courts for alleged violations by financial institutions of consumer financial protection statutes.

While this article will focus on alleged violations of the Real Estate Settlement Procedures Act ("RESPA") and the Truth in Lending Act ("TILA") by way of examples of the impact of recent and ongoing litigation, the cases discussed will have broad impact on all alleged statutory violations with similar injury-in-fact issues arising under federal statutes beyond RESPA and TILA. These include the Fair Credit Reporting Act, the Fair Debt Collection Practices Act and privacy and data security laws.

U.S. Supreme Court Sends Warning: Overturned Lower Court Decision

Financial institutions cannot take any comfort from recent decisions of the U. S. Supreme Court related to consumer protection statutes such as TILA and RESPA. Although the U.S. Supreme Court does not devote many of its limited number of opinions each year to lender compliance, the Court's October Term 2014 TILA decision provides an indication of the attitude of the nation's highest court and its willingness to overturn lower court decisions favoring lenders.

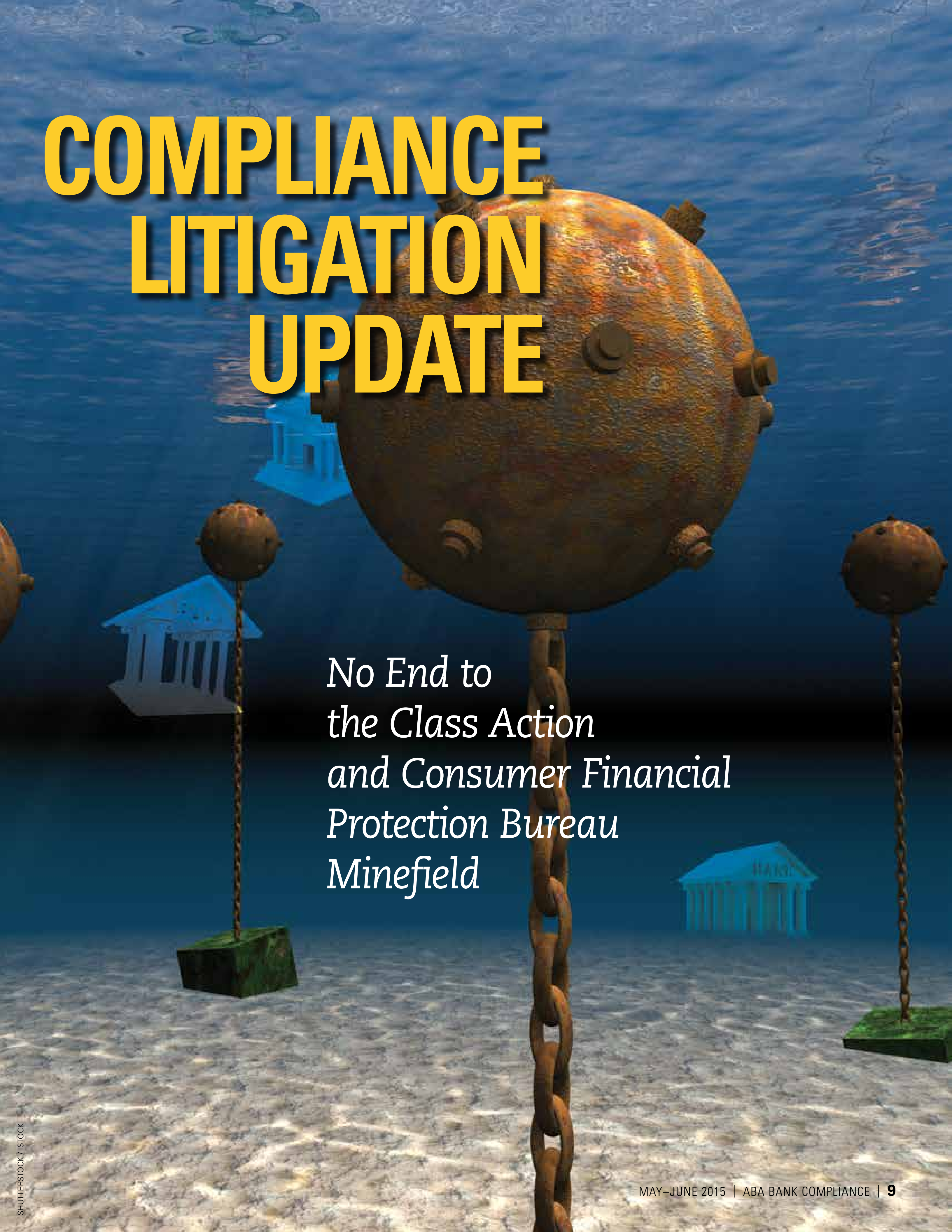
In *Jesinosky v. Countrywide Home Loans, Inc.*, the U.S. Supreme Court overturned TILA opinions favorable to the lender by the federal District Court and the Eighth Circuit Court of Appeals. At issue were Sections 1635(a) and (f) of TILA, which provide a consumer with a three-day right of rescission in certain loan transactions, but extend that right to *three years* if a lender fails to provide proper disclosures at the time the loan transaction is consummated.

Larry and Cheryle Jesinoski refinanced their home mortgage by borrowing $611,000. Exactly three years later they mailed a loan rescission letter to the lender. More than a year after the rescission letter was mailed, they filed suit. Those facts are not in dispute. Nor was it disputed that the borrowers could have rescinded by a simple letter within three days after the loan closed. What was in dispute was whether the lender's disclosures were proper. On those facts, the District Court granted, and the Eighth Circuit Court upheld, dismissal of the *Jesinoski* complaint without a trial on the grounds that, where the lender disputed the inadequate disclosure claim, to preserve the right to rescind after the third day, the borrower must begin litigation within three years of closing the loan.

Under the lower court decisions, once the three day rescission period had elapsed, the lender, or a purchaser of a loan, could have reasonable confidence, if the lender believed that the disclosures were proper, that a loan could not be rescinded unless the borrower was willing to file a lawsuit demanding rescission—not a step taken lightly. In *Jesinoski*, despite the fact that the borrower sent a rescission letter two years, eleven months, and twenty-nine days after the loan closed, and did not file a formal complaint until more than a year later, the U.S. Supreme Court overturned the Eighth Circuit Court, reinstated the *Jesinoski* complaint, and sent the case back to the lower court to determine whether the disclosures were proper. In short, the Court

COMPLIANCE LITIGATION UPDATE

No End to the Class Action and Consumer Financial Protection Bureau Minefield



SHUTTERSTOCK / ISTOCK

concluded that borrowers can send a simple letter at the eleventh hour and let the lender remain on tenterhooks as to whether and when a rescission complaint might be filed.

Although perhaps narrow in its particular application, the *Jesinoski* case sends a warning to the financial industry that the U.S. Supreme Court, and therefore the lower courts which do not wish to be overruled, may side with the borrower, not the lender, in the interpretation of federal financial institution compliance law and regulations.

Jesinoski Decision and "Lack of Proof of Damages" Significant

Jesinoski, decided in 2014, is particularly significant in light of the U. S. Supreme Court's 2012 refusal to hear an appeal of the *Edwards v. First American Title* case and the Court's subsequent action in the 2014 *Spokeo, Inc. vs. Robins* appeal. The *First American* plaintiff filed a class action lawsuit claiming that a title insurance charge was an illegal kickback in violation of RESPA, even though plaintiff Edwards was not overcharged for title insurance nor suffered actual damages. The plaintiff claimed that *First American* violated RESPA by overpaying for a minority ownership interest in Tower City Title Agency LLC in exchange for Tower's agreement to refer all future Tower's title insurance business written in the state of Ohio, exclusively to *First American*.

Financial institutions cannot take any comfort from recent decisions of the U. S. Supreme Court related to consumer protection statutes such as TILA and RESPA.

Although dealing with alleged RESPA violations due to business arrangements by a title insurer, not a mortgage lender, *First American* is important because the U.S. Supreme Court agreed in June 2011 to review the decision of the federal Court of Appeals Ninth Circuit holding that RESPA gives a borrower a statutory cause of action and standing to pursue that action despite the lack of any actual damages. The Ninth Circuit Court held that, since RESPA provides that a person who is charged for a settlement service in violation of RESPA, is entitled to three times the amount of any charge paid, liability is not limited to instances in which a plaintiff is overcharged.

After a very active oral argument, the U.S. Supreme Court's June 2012 *First American* ruling was widely expected to decide whether or not a plaintiff had standing to sue for statutory damages without suffering actual injury from the alleged RESPA violation. Instead the U.S. Supreme Court concluded the appeal was "improvidently granted" and therefore dismissed the petition to hear an appeal and let the lower court's decision stand. The Ninth Circuit Court ruling, neither affirmed nor overturned by the U.S. Supreme Court, makes class action certification more likely because one key area in which plaintiffs may differ, making certification difficult, is proof of damages. Broader applicability of class action lawsuits means that plaintiffs' lawyers can commence major litigation in matters which would otherwise be much less likely to result in private litigation.

U.S. Supreme Court, CFPB, RESPA, and Class Action Litigation Intersect

First American is particularly important because of the intersection of the U.S.Supreme Court, the CFPB, RESPA and class action litigation. In December of 2012, after the case returned to the lower courts, the U.S. District Court for the Central District of California certified a relatively small class of consumers claiming *First American*'s relationship with Tower Title had violated RESPA, but refused to certify a much broader nationwide class targeting two hundred other title agencies that are partially owned by *First American*. The District Court held that "in light of the multiplicity of disparate, individualized issues that would need to be adjudicated to determine defendants' potential liability to the proposed nationwide class, the court finds that common issues of fact and law do not predominate."

In *First American*, the CFPB filed a "friend of the court" brief arguing that even the District Court holdings do not go far enough in interpreting the language or purpose of RESPA or its implementing regulation, Regulation X. The CFPB stated that the District Court erred in stating that proof of overpayment was required (because payments for goods, services, and facilities generally are permitted by RESPA and Regulation X) arguing that the safe harbor does not apply when payments are made to purchase ownership interests in an entity, nor does it permit parties to enter into agreements to circumvent the general prohibition on referral payments. The CFPB also argued that RESPA does not require a plaintiff receiving multiple referrals to prove that the unlawful referral was the influential one. Rather the CFPB claimed that in order to "vindicate Congress's overarching goal of rooting out paid referrals from the settlement services industry" the law provides that liability and the amount of damages are fixed once a referral in violation of RESPA is made.

U.S. Supreme Court, Federal Lending Law Compliance, and Class Action Litigation May Be Revived In Appeal

The intersection of the U.S. Supreme Court, federal lending law compliance, and class action litigation may be revived in 2015 in *Spokeo, Inc. v. Robins*, if this time the Court agrees to hear an appeal from a decision of the federal Ninth Circuit Court of Appeals. The plaintiff, Robins, alleged Spokeo violated his rights under the Fair Credit Reporting Act ("FCRA") but did not allege actual or imminent harm. FCRA requires consumer reporting agencies to "follow reasonable procedures to assure maximum possible

Bank management would be well advised to aggressively scrutinize and monitor joint activities of any kind with title companies, builders, insurers or other participants in the mortgage industry for any possible kickback claims.

accuracy" of consumer reports. Spokeo operates a website that provides information about individuals, including contact data, marital status, age, occupation, and wealth level. The plaintiff claimed Spokeo's website stated he held a graduate degree and was wealthy, when he did not and was unemployed. The District Court dismissed the case, finding the plaintiff failed to plead an injury resulting from Spokeo's violations. On February 4, 2014, the Ninth Circuit Court of Appeals reversed the District Court's decision and held the plaintiff had standing to sue Spokeo because "a plaintiff can suffer a violation of the statutory right without suffering actual damages."

On October 6, 2014, the U.S. Supreme Court invited the United States Solicitor General to brief the Court on whether or not to hear the *Spokeo* appeal. Since in *First American* the Solicitor General favored standing based solely on the violation of a statutorily created right, this action may indicate that the Court will accept the appeal of the *Spokeo* class action case. A U.S. Supreme Court opinion in *Spokeo* in 2015 would broadly impact consumer class actions for alleged statutory violations with similar injury-in-fact issues arising under federal statutes beyond FCRA, including RESPA, TILA, the Fair Debt Collection Practices Act and privacy and data security cases, in which plaintiffs have had difficulty establishing actual harm caused by the defendant. In contrast, complaints alleging that fees charged to borrowers violated TILA because they were not "bona fide and reasonable in amount" were previously denied class action status because courts have held that the inquiry requires a loan-by-loan and fee-by-fee analysis, each in the context of the applicable market locality. Examples include the 2011 Eastern District of Virginia cases of *Parham v. HSBC Mortg. Corp.* and *Hudson v. Bank of America.*

In considering the possible impact of a Spokeo decision favoring statutory damages in class actions, it is instructive to review the federal Eleventh Circuit Court's December 10, 2014 decision *Darcel Harris vs. Harvey Schonbrun, Trustee*, dealing with the right of rescission under TILA. On October 16, 2009 Harris entered into a mortgage loan with Schonbrun, the trustee of a mortgage investment trust. Two years later Harris defaulted, the lender began foreclosure, and the borrower demanded rescission of the loan. Harris filed a complaint in the United States District Court for the Middle District of Florida on April 27, 2012, and although the facts were disputed, the District Court found that the lender had instructed the borrower to sign simultaneously both the loan documents and a post-dated waiver of the borrower's right to rescind, which the District Court found not to be "clear and conspicuous" notice of the right to rescind. The federal Middle District Court of Florida granted rescission, but denied statutory damages, attorney's fees and costs on the grounds that the lender did not materially violate TILA and the borrower was not actually harmed by the violation.

The Eleventh Circuit Court reversed the District Court stating, "whether Harris was actually deceived or harmed by Schonbrun's noncompliance with the Act is irrelevant." The Eleventh Circuit ruled that "the district court lacked the discretion to deny Harris statutory damages, attorney's fees and costs, . . . " Even more importantly, the Court held that " . . . the reasonableness of attorney's fees and costs is not limited by the dollar value of the underlying loan agreement" meaning that in such cases the borrower's attorney's fees charged to the lender can be many times greater than the dollar value of the original loan. With that incentive, it is not hard to imagine a creative plaintiff's lawyer developing a statutory damages class action case for TILA violations.

More CFPB RESPA Litigation:

Despite, or perhaps because of, the U.S. Supreme Court's failure to hear the *First American* appeal, the CFPB has stepped up RESPA litigation. As an example, consider the outcome of a CFPB RESPA complaint filed January 22, 2015 in the United States District Court for the District of Maryland, captioned *Consumer Finance Protection Bureau and State of Maryland vs. Wells Fargo, JPMorgan Chase, and Elaine and Todd Cohen.* The complaint alleged that from 2009 through 2013, Genuine Title, LLC provided loan officers with marketing services that increased the number of loans originated or refinanced by the lenders and that, in exchange, the loan officers referred settlement-service business to Genuine Title. The complaint alleged that the marketing services included Genuine Title purchasing leads from a third party vendor and paying for "marketing letters directed to the consumer leads to be printed, folded, stuffed into envelopes and mailed."

With respect to Wells Fargo, the complaint alleged that more than one hundred loan officers from eighteen branches participated in the marketing plan, some branch managers were aware of the plan and falsified invoices were prepared to disguise the marketing plan. The complaint alleged that six loan officers at three JPMorgan Chase branches participated.

Todd Cohen was a loan officer for Wells Fargo and Elaine Cohen was his spouse. The complaint alleged that while at Wells Fargo and at an "Unnamed Financial Institution" Todd Cohen participated in the marketing plan and that while at the "Unnamed Financial Institution" payments were made to Elaine Cohen in conjunction with the marketing plan. Before the CFPB began its investigation, the "Unnamed Financial Institution" undertook its own investigation and fired Todd Cohen.

The 2015 case resulted in three separate Stipulated Final Judgments and Orders of the federal District Judge. While none of the defendants admitted the complaint allegations stated above, the agreed upon penalties were very significant. Wells Fargo suffered a judgment in the amount of $10,809,807.71 in damages to consumers, a civil money penalty of $3,000,000, and various reporting, notice, and record keeping requirements. JPMorgan Chase Bank suffered a judgment in the amount of $300,753 in damages to consumers, a civil money penalty of $500,000, and reporting, notice and record keeping requirements similar to those agreed to by Wells Fargo. Todd Cohen, one of the involved loan officers, was banned from any professional involvement in the mortgage industry for two years, and he and his spouse suffered a civil money penalty of $30,000.

In contrast, the "Unnamed Financial Institution" where Todd Cohen was also employed and also participated in the same marketing scheme for over a year, suffered no penalties and was not even mentioned by name in the complaint. Unlike the allegations against the named financial institutions however, the complaint states that the "Unnamed Financial Institution"—before the CFPB even began its investigation—conducted its own "thorough" investigation and terminated the loan officer's employment. In this litigation, the CFPB acted in a way analogous to a government funded class action plaintiffs' lawyer. In addition to significant civil money penalties, the District Court imposed judgments totaling millions of dollars which are to be paid to borrowers as damages. The actions of the "Unnamed Financial Institution" demonstrate that supervision and action by management may avoid great reputational and monetary harm to lenders.

Enforcement Action Cooperation

The CFPB and other financial institution regulators are cooperating in enforcement actions, especially in RESPA anti-kickback enforcement. On May 14, 2013, in a CFPB Administrative Proceeding, a Consent Order was entered into between the CFPB and Paul Taylor, Paul Taylor Homes and Paul Taylor Corp. The underlying facts were that the Paul Taylor homebuilding organization and Benchmark Bank entered into a joint venture known as Stratford Mortgage Services. Stratford was capitalized by $25,000 from each of the venturers, performed all its work through one employee of the bank, did not own or rent any office space, did no advertising, and derived all its mortgage originations from the Paul Taylor homebuilding organization. The CFPB Consent Order arose out of a prior Federal Deposit Insurance Corporation ("FDIC") stipulated Order to Pay issued June 1, 2012 against Benchmark Bank, a Texas chartered bank headquartered in Plano, Texas. In neither Order did the homebuilder or the bank admit the government allegations, but agreed to payments to the CFPB and the FDIC respectively. Bank management would be well advised to aggressively scrutinize and monitor joint activities of any kind

FINANCIAL INSTITUTION LITIGATION COSTS:

By Alexander Henderson, III, Esquire

The cost of litigation at large banks has been much in the financial press in the last couple years. Following the 2008 financial crisis there has been increasingly vigorous U.S. government enforcement of sanctions against large banks. *Bloomberg News* published an article headlined "*U.S. Banks Legal Bills Exceed $100 Billion*" (Griffin and Campbell, August 28, 2013). *Bloomberg* analyzed quarterly reports to the Federal Reserve, the Securities and Exchange Commission and investors from January 2008 through June 2013 for the article. The "*100 Billion*" headline both overstates and understates the actual legal bills. The article's totals only include the six largest U.S. Banks: Bank of America, JPMorgan, Citigroup Inc., Wells Fargo & Co., Goldman Sachs Group Inc. and Morgan Stanley. However, many other financial institutions have significant litigation expense, including large overseas banks with U.S. operations such as HSBC Holdings Plc, UBS AG, Barclays Plc, UBS and Royal Bank of Scotland Group Plc. On the other hand, according to *Bloomberg*, the $103 billion figure includes settlement amounts – legal fees and litigation costs were "only" $56 billion at the six big banks. Interestingly, legal fees and litigation costs exceeded the total amount paid in settlements.

According to *Bloomberg*, legal fees and costs in 2012 and the first half of 2013 represent about forty percent of the total fees and costs for the entire five and a half year period. Substantial additional legal fees and costs have undoubtedly been incurred since mid-2013. Article authors Griffin and Campbell note that the $103 billion in fees, costs and settlements exceeded the total amount the six big banks paid in dividends from 2007 through June of 2013 and the legal fees and costs alone for the period nearly equaled their combined 2012 profits.

In late 2014, Boston Consulting Group, a large global management consulting firm, issued a report widely covered in the financial media concerning litigation costs of both European and U.S. banks. According to the BCG Report, leading banks in the U.S. and the E.U. paid settlement claims of $3 billion in each of 2009 and 2010, $22 billion in 2011, $44 billion in 2013 and $60 billion in the first nine months of 2014. According to BCG, of the $115 billion aggregate U.S. bank settlement total from 2009 through 2014, ninety-eight percent arose from U.S. regulators' claims (and 45% of the E.U. bank total arose from U.S. regulator claims). The "leading" banks are the six largest in the U.S. and the twelve largest in the E.U. Fines and

… lenders' regulatory compliance mind-set must embrace a good-citizen approach which actively seeks to comply with the wider intent and purpose of consumer-focused regulations.

with title companies, builders, insurers or other participants in the mortgage industry for any possible kickback claims.

The CFPB also shares information with the Office of the Comptroller of the Currency, the Department of Justice and other government agencies through interagency agreements. The CFPB has access to information obtained by other agencies which relate to the CFPB's enforcement authority. The CFPB will share information it obtains through its investigations with law enforcement authorities.

The Big Picture

The broader lesson from recent litigation activity, both by plaintiffs' lawyers and government regulators, is that lenders' regulatory compliance mind-set must embrace a good-citizen approach which actively seeks to comply with the wider intent and purpose of consumer-focused regulations. This can be accomplished through continual education and supervision of front line personnel, not just in RESPA and TILA matters, but also in Bank Secrecy Act, Anti-Money Laundering, privacy and other financial institution regulatory matters. ■

ABOUT THE AUTHOR:

ALEX HENDERSON is Chief Counsel of Teraverde Management Advisors and General Manager of Teraverde's Compliance Services unit. The Teraverde unit serves the needs of banks, independent mortgage bankers and other financial institutions in compliance matters such as RESPA/TILA, Bank Secrecy Act/Anti-Money Laundering, Cyber-security, and Compliance Management Systems. Mr. Henderson has practiced law for more than thirty years with extensive experience in financial institution matters, was managing partner of a law firm for twelve years, and was head of the law firm's Financial Practice Group. Mr. Henderson has been named as a Pennsylvania Super Lawyer® by the Super Lawyers rating service and magazine. Alex Henderson can be reached at **ahenderson@teraverde.com** or (717) 299-7242 ext 205, and for more information visit **www.teraverde.com.**

NOT JUST FOR LARGE BANKS ANYMORE

settlements under $50 million were excluded from the statistics.

In the fall 2014 Report, the BCG recommended that global banks establish a comprehensive, up-to-date risk inventory reflecting all regulatory and business conduct requirements, clearly allocate responsibilities within the first and second lines of defense with specific controls, drive full integration into the bank's operating model, identify the most important controls through group-wide risk-assessment standards, ensure outcomes of controls with a proper reporting framework, and review the effectiveness of controls on a regular basis.

As my accompanying "Compliance Litigation Update" feature article concerning trends in compliance litigation demonstrates, significant legal fees, costs and settlements are not just for the six biggest banks any more. The Consumer Financial Protection Bureau, in cooperation with prudential regulators, is aggressively pursuing non-compliance by organizations of all sizes. The six largest U.S. banks may be able to withstand legal fees, costs and settlements which exceed an entire year's profits, or four years' worth of dividends, but community banks and other smaller financial institutions may not be able to do so. Legal fees and costs of litigation do not necessarily decline in proportion to the size of the financial institution or the size of the claim. As the CFPB and other regulators increasingly drill down to smaller institutions and smaller claims, litigation expense for smaller institutions is likely to be a greater percentage of revenues than for the largest global banks. In addition, expanded class action certifications may mean that plaintiffs' lawyers initiate class action lawsuits which would have previously been uneconomic and which include small and mid-size institutions.

No financial institution of any size can afford to treat compliance officers, compliance protocols and legal review of compliance plans and systems in general as cost centers to be minimized. Rather it must be recognized at the Board of Directors and Chief Executive Officer level that they are important means to avoid future legal fees, litigation costs, and settlement expense. Even more than the largest global banks, smaller institutions must have compliance management systems which take into account up-to-date regulatory and business conduct risks. To best minimize unnecessary litigation expense, each institution's compliance management system must specifically allocate compliance responsibilities with controls integrated into the operating model, establish a reporting framework, and require regular review of effectiveness.