FINANCIAL SERVICES REPORT

Award Winning Newsletter

Quarterly News, Summer 2013

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MOFO METRICS

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43	Percentage of college-level grades that are A's
3	Percentage of spam emails that get past anti-spam filters
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3	Average weight of a human brain, in pounds
3	Total weight of human bacteria, in pounds

MORRISON FOERSTER

Editor's Note

It's time again to put on the cranky pants and lay down a groove. The IRS got into trouble this quarter for belief-based harassment. The targeted groups now get to wallow in the limelight. They are as thick as cicadas, suing, giving TV interviews, and behaving put upon. We want to know, where's our wallow? Somehow, this newsletter got passed over. Not enough shrill? Doubt it. We asked Lois Lerner but she left us a voicemail saying she was busy and would get back to us on the fifth. It's enough to put the "ire" back in IRS. (Product Placement Alert: Lululemon offers a complete line of cranky pants – ours comes with an expandable waistline.)

Did we mention we listen? It turns out our readers can't get enough Bureau jokes. This one is no joke: CFPB employees want to unionize because they are, um, unhappy. Couldn't they just join our conga line? (Some thought being miserable was a CFPB job description.) What really got them off-leash was management's decision to build out the CFPB headquarters as open space—think "cube farm"—without individual offices. This will be good to know when you get examined. It will be public and open: Latex gloves, no hospital gown.

If you "like" our terroir, you can fill out our customer satisfaction survey. Just go to www.Mofo.crankypants.com, register with a simple alphanumeric password that must include at least two punctuation marks (one of which must have a squiggle) and the initials of your mother's maiden name, print out the form on 20-lb canary paper (double-sided), fill in the answer bubbles completely (#2 pencil), affix a commemorative Latin music legends "forever" stamp, and leave in your glove compartment.

Until next time, remember: Google Glass only look like arc-welding goggles, ask your coffee designer for references, and avoid North Korean fireworks.

William Stern, Editor-in-chief

ARBITRATION REPORT

Ninth Circuit Punts

In *Kilgore v. Keybank, N.A.*, the Ninth Circuit was poised to decide whether the Supreme Court's *Concepcion* decision vitiates California's "public" injunction exemption from arbitration. Under that exemption, California courts have held that the federal policy in favor of arbitration under the FAA inherently conflicts with statutes, such as California's unfair competition law, that authorize "public" injunctive relief. The *en banc* court did not reach the issue, ruling instead that plaintiffs sought relief solely for their own benefit so the exemption did not apply. *Kilgore v. Keybank, N.A.*, Nos. 09-16703, 10-15934, 2013 U.S. App. LEXIS 7312 (9th Cir. Apr. 11, 2013). The court held plaintiffs were required to arbitrate their claims against the originating bank and loan servicer of the student loans they challenged.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

TCPA Suit Sent to Arbitration

A Florida federal court granted BBVA Compass Bancshares Inc.'s motion to compel arbitration in a putative class action brought by a Florida cellphone user alleging the company violated the Telephone Consumer Protection Act (TCPA) by sending out unsolicited text messages promoting its mobile banking application. The plaintiff's user agreement with BBVA contained an arbitration provision. The court declined to consider plaintiff's argument that his TCPA claim is not covered by the arbitration provision, because the arbitration agreement contained a provision that the arbitrator, not the court, should consider questions of arbitrability. *Shea v. BBVA Compass Bancshares, Inc.*, No. 1:12-cv-23324-KMM, 2013 U.S. Dist. LEXIS 31906 (S.D. Fla. Mar. 7, 2013).

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Severing the Unconscionable

A California appeals court actually reversed a decision denying a motion to compel arbitration! *Mercedes-Benz Fin. Servs. USA, LLC v. Okudan*, No. D061669, 2013 Cal. App. Unpub. LEXIS 2478 (Apr. 8, 2013). In an unpublished opinion, the court agreed with the trial court that provisions in a Mercedes-Benz Financial Services contract that authorized a new arbitration for final awards that exceeded $100,000 was unconscionable. However, the court remanded to the trial court to consider whether the unconscionable provisions could be severed.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

BUREAU REPORT

Time for Recess

Litigation continues in *Noel Canning v. NLRB*, where the U.S. Court of Appeals for the D.C. Circuit recently ruled that President Obama improperly used his recess appointment authority to appoint three members to the National Labor Relations Board. Bureau watchers continue to buzz about the implications of this case, as Consumer Financial Protection Bureau (CFPB) Director Richard Cordray was appointed under the same circumstances.

The NLRB and the Obama Administration filed their petition for *certiorari* on April 25, 2013. Noel Canning did not oppose the petition in its response. Supreme Court watchers expect the Supreme Court to grant the petition, although the case will not be heard until the fall at the earliest.

In the meantime, the Third Circuit agreed with the D.C. Circuit, finding recess appointments to the NLRB in 2010 were

AMERICAN COLLEGE HONORS RICK FISCHER

Rick Fischer has been awarded the Lifetime Achievement Award by the American College of Consumer Financial Services Lawyers, which is the highest honor bestowed by the College. The award is granted periodically by the College to recognize significant contributions in the field of consumer financial services. Rick was recognized for his longtime counsel to a wide range of clients on retail banking, payment services and financial regulatory issues. Roland Brandel is a prior recipient of the award, and with this honor, Morrison & Foerster is the only organization or firm to have two recipients of the Lifetime Achievement Award.

An appreciation of Rick was prepared. It helps to put in perspective Rick's many accomplishments and contributions to our firm, regulatory policy, and the financial services industry. You can read it here.

Congratulations Rick!

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invalid as well. *NLRB v. New Vista Nursing & Rehab.*, No. 11-3440 et al., 2013 U.S. App. LEXIS 9860 (3d Cir. May 16, 2013). The Third Circuit relied on different reasoning than the D.C. Circuit, but reached the same conclusion.

For more information, contact Oliver Ireland at oireland@mofo.com.

"Compliance U" for Student Loan Servicers

In addition to holding field hearings and publishing numerous reports and blog posts about the student loan debt crisis, the CFPB has proposed a Larger Participant Rulemaking to bring non-bank student loan servicers under its supervisory purview. The proposal would apply to those entities that service both federal and private student loans, with the CFPB coordinating supervision of servicers of federal loans with the Department of Education. This is the third Larger Participant Rulemaking issued by the CFPB. In its first two rules, the CFPB set the "larger participant" threshold at $7 million (credit bureaus) and $10 million (debt collectors) in sales. In this more recent rulemaking, the metric used is number of loans serviced, and the CFPB has set the bar at one million accounts, which the CFPB has said will capture the seven largest student loan servicers.

For more information, contact Leonard Chanin at lchanin@mofo.com.

Spouses in, Roommates out

The CFPB finalized an amendment to Regulation Z's ability-to-pay requirements to expand access to open-end credit to those spouses, partners, and family members who do not earn an income outside of the home. The amendment permits a credit card issuer to consider income to which an applicant has a "reasonable expectation of access" that is used to regularly pay the applicant's expenses, like a bank account funded by a working family member.

Issuers may assess an adult applicant's ability to pay in a variety of ways. However, the CFPB opted not to permit issuers to rely solely on responses to prompts for household income, citing concerns that applicants may mistakenly think they have a reasonable expectation of access to their roommate's income.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Now That's More Fee-sible

The CFPB announced a final rule amending Regulation Z to eliminate limits on pre-account opening fees, notwithstanding Regulation Z's current prohibition on first-year fees in excess of 25% of a cardholder's credit limit. The CFPB warns credit card issuers, though, that it will "continue to monitor the credit card market to determine if it should take further action to protect consumers." The revision reflects a court ruling that limits on pre-account opening fees went beyond the authority in the CARD Act requiring limits on first-year fees.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

What's It Gonna Take to Put You in This Brand New Guidance Today?

Continuing its tradition of regulating without rulemaking, on March 21, 2013, the CFPB published a guidance bulletin on fair lending compliance for indirect auto lenders. The bulletin announces the CFPB's concerns that indirect auto lending may introduce discriminatory lending practices, as auto dealers are given discretion to further mark up a borrower's interest rate at the point of sale. By doing so, the bulletin reflects the CFPB's view that discrimination may be proven through disparate impact, a theory that may yet be the subject of Supreme Court review.

The guidance also serves as an end-run around the Dodd-Frank Act's restrictions against the CFPB regulating the conduct of auto dealers, and indicates the regulatory gymnastics the CFPB is prepared to engage in to extend its reach beyond traditional consumer financial services market participants.

For more information, read our Client Alert or contact Leonard Chanin at lchanin@mofo.com.

Try Try Again with Re-Re-Remittance Transfer

Many Justin Bieber coifs ago there were remittance transfer rules. The CFPB just released another round of amendments to its remittance transfer regulations. The revisions (1) relax a requirement for remittance transfer providers to disclose foreign taxes and fees imposed by a non-affiliated recipient institution and (2) reduce providers' liability when sender error causes funds to be deposited into an incorrect recipient's account. The CFPB also pushed back the effective date of the remittance transfer regulations yet again, to October 28, 2013. On a related topic, the CFPB recently announced that it is accepting money transfer complaints. Unfortunately, the new intake forms don't seem to have an option for complaints about the CFPB's perpetual revisions to the remittance transfer rules.

For more information, contact Sean Ruff at sruff@mofo.com.

Burning a Hole in Their Pockets

The CFPB issued a final rule for administering its civil penalty fund, which is flush with funds due to the penalties imposed by the CFPB in its high-profile consent orders. The final rule—issued without a proposed rule—establishes a fund administrator, who is empowered to allocate funds to eligible victims or to consumer education and financial literacy programs. The rule requires the fund administrator to establish a schedule of six-month payment periods, at the end of which funds will be paid to eligible victims for their "uncompensated harm" (defined by the rule to be the harm caused by the consumer law violation minus any redress the victim has received or can expect to receive). If funds remain after the six-month distribution period, the Fund Administrator may make payments to financial literacy and consumer education programs.

For more information, contact Andrew Smith at andrewsmith@mofo.com.

Complaint Data Dump

On March 28, 2013, the CFPB released additional consumer complaint data, expanding the publicly available information to include complaints on mortgages, bank accounts and services, private student loans, and other consumer loans. The database is now considered

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"live" and will include daily updates as the CFPB receives and processes new complaints. Each new complaint will be added to the database 15 days after it is received by the company.

The CFPB highlighted that it had received over 130,000 consumer complaints, including 30,600 credit card complaints, 63,700 mortgage complaints, and 4,100 consumer loan complaints through February 2013. Nearly half of the complaints were submitted through the CFPB's website, and another third came in as referrals from other regulators.

For more information, contact Andrew Smith at andrewsmith@mofo.com.

Mr. Smith Goes to the CFPB

In March, the CFPB announced it had created an Office of Financial Institutions and Business Liaison. The Office will "connect the CFPB with bank and nonbank trade associations, financial institutions, and businesses" in an effort to enhance communication and collaboration between the CFPB and industry participants. Dan Smith, formerly the Director for Industry and State Relations at Freddie Mac, will serve as the office's first Assistant Director.

For more information, contact Andrew Smith at andrewsmith@mofo.com.

CFPB Just Keeps on Growing

The CFPB's fiscal year 2013 and 2014 budgets and its strategic plan through fiscal year 2017 confirm what CFPB watchers already knew—the CFPB is planning for expansion. It plans to have 1,545 full-time employees by the end of 2014. And they'll be busy—CFPB's "supervision activities" continue to expand, with 149 actions opened in 2012, including 67 focused on fair lending. Also of note, the CFPB has budgeted $2.5 million for fiscal year 2014 to establish a "registration system," which will be "a system to implement a registration requirement, to be established by rule, for certain nonbank providers of consumer financial products and services. Registration of certain nonbanks will help the Bureau better understand the markets and institutions that it regulates."

For more information, contact Leonard Chanin at lchanin@mofo.com.

PRIVACY REPORT

Cybersecurity Legislation, Again

On February 12, 2013, President Obama issued his cybersecurity Executive Order, directing the federal government to take various steps to protect the nation's critical infrastructure from cyber threats. Congress has continued to consider cyber security legislation, but remains sharply divided on the substance and breadth of an appropriate bill. The House passed H.R. 624 to provide for the sharing of cyber threat intelligence and information between and among the intelligence community and the private sector. The bill includes certain privacy provisions supported by the Administration. The Senate has yet to introduce any legislation this year.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

White House Privacy Blueprint

The Obama Administration released a privacy blueprint with recommendations for creating a new consumer privacy protection framework in the U.S. The framework would include a consumer privacy bill of rights and introduce a process to create codes of conduct to implement this bill of rights. According to the Administration, the privacy bill of rights is designed to provide baseline protections for consumers and greater certainty for companies. It would apply to all commercial uses of "personal data," which the blueprint defines as "any data, including aggregations of data, which is linkable to a specific individual," and any data that is linked to a specific computer or device. The bill of rights is based on Fair Information Practice Principles, including individual control, transparency, respect for context and access, and accuracy. The Administration's recommendations also would strengthen Federal Trade Commission (FTC) enforcement authority on privacy matters.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

FTC Focuses on Privacy Too

The FTC issued a report providing best practices for businesses to protect consumer privacy and give consumers greater control over the collection and use of personal information relating to them. The report recommends that Congress enact general privacy legislation, data security and breach notification legislation, and data broker legislation. Recommendations for business include: 1) building in consumer privacy protections at every stage of product development, including limits on the collection and retention of data; and 2) allowing consumers to decide what information is shared about them and with whom, including a "do-not-track" mechanism that would provide a simple, easy way for consumers to control the tracking of their online activities.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

So Does the NTIA

The National Telecommunications and Information Administration (NTIA) has been continuing its multi-stakeholder process to develop privacy codes of conduct. Back in March 2012, the NTIA published a request for comment on consumer data privacy issues that the NTIA believes warrant the development of legally enforceable codes of conduct, as well as procedures to foster the development of such codes. On April 29, 2013, the NTIA released a discussion draft of a short-form notice designed to enhance transparency about mobile apps' data collection and sharing practices.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

FTC: Paper, Plastic, or Mobile

FTC staff issued a report highlighting key issues facing consumers and companies as they adopt mobile payment services. The report focuses on three major areas of potential concern for consumers: (1) the need for companies to have clear policies on how consumers can resolve disputes arising from a fraudulent mobile payment; (2) the need for industry-wide adoption of strong measures to ensure security throughout the mobile payment process; and (3) the need for companies in the mobile payment sphere to practice "privacy by design," incorporating strong privacy practices,

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consumer choice, and transparency into their products from the outset.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

Life of PII

The Massachusetts Supreme Judicial Court held that a retailer's request for a ZIP code at the point of purchase is an unfair and deceptive practice under the state's UDAP law. In answering questions certified by the federal court, the Supreme Court decided that an individual's name and ZIP code can be considered personal information because they provide sufficient information to identify the individual using publicly available sources. If the experience in California is any indication, expect a wave of litigation to follow.

For more information, read our Client Alert or contact Purvi Patel at ppatel@mofo.com.

Mind Your Privacy Manners

The Network Advertising Initiative (NAI) released a revised draft code of conduct to address current industry best practices for data collection by companies engaged in online behavioral advertising and related practices. The code, which was last updated in 2008, imposes notice, transparency, choice, and data security requirements on NAI member companies. It would require NAI member companies to provide enhanced notice on their Web sites describing their data collection and use practices and the choices available to users in and around the targeted ads they serve. The NAI explained that one of the purposes of the revised code is to incorporate principles from the FTC's report on online behavioral advertising, particularly the enhanced notice requirement, which had not yet been included in the NAI code.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

Unfriendly Skies for the CA AG

A California state court dismissed with prejudice the California Attorney General's first attempt to enforce the state's Online Privacy Protection Act (OPPA). The AG brought suit against Delta Air Lines challenging the airline's alleged failure to include a privacy policy with its mobile app. Reports indicate that the court held the AG's use of the OPPA was preempted by the federal Airline Deregulation Act in attempting to rely on state law to regulate an airline's "services," as defined in the Act. Unfortunately, the court did not reach any of the substantive issues concerning the application or scope of the OPPA.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

MORTGAGE REPORT

SG's Late to the Party

Seven months after the Supreme Court issued its invitation, the Solicitor General finally filed its brief in the disparate impact case, *Mount Holly Gardens Citizens in Action, Inc. v. Township of Mt. Holly*. The Solicitor General advises the Court against taking the case. Predictably, it argues that HUD's new rule on the topic is entitled to deference and that the case does not warrant review because there is no conflict in the courts of appeals. The Township filed a response on May 24, and the Justices will now consider the matter at their June 13 conference. All of this may be moot, though, as press reports indicate this case may be settled before the Supreme Court can take up the issue. Yes, this is exactly what happened when the Supreme Court took up the issue in *Manger v. Gallagher*, minus, hopefully the worst of the backroom intrigue.

The DOJ also showed its love for disparate impact theories, filing a statement of interest in a district court case opposing the lender's argument that disparate impact claims are not authorized by the FHA. The DOJ relied, in part, on HUD's new disparate impact rule (which we reported on here).

For more information, contact Tom Noto at tnoto@mofo.com.

Regulators Go Back to the Future with Redlining Claims

In March 2013, DOJ and an eight-branch community bank in Michigan entered into a consent order regarding alleged redlining of majority-African-American census tracts in the Saginaw and Flint, Michigan metropolitan areas. The consent order requires the bank to open a loan production office in a majority-African-American neighborhood of the City of Saginaw and to fund a various programs to encourage and increase lending in the redlined tracts. DOJ's press release announced that the case was litigated by the Financial Fraud Enforcement Task Force's (FFETF) Non-Discrimination Working Group, an "interagency initiative, established . . . to wage an aggressive, coordinated and proactive effort to investigate and prosecute financial crimes."

For more information, contact Wendy Garbers at wgarbers@mofo.com.

Unsecured Consumer Loans in the Fair Lending Crosshairs

In March 2013, the DOJ and Texas Champion Bank entered into a consent order regarding the bank's alleged charging of higher prices on unsecured consumer loans made to Hispanic borrowers than to similarly-situated non-Hispanic white borrowers through the bank's branch offices. The consent order requires Texas Champion to pay $700,000 to "Hispanic victims of discrimination," "further revise" the uniform rate matrices it uses to price unsecured consumer and other loans the bank offers, and beef up training and monitoring programs.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Hangover, Part III

The CFPB issued a proposed rule "clarifying and making technical amendments" to the 2013 Escrows Final Rule issued in January. The proposed rule (1) temporarily extends existing higher-priced mortgage loan rules by six months to clear up an ambiguity that could be read to cut off the old protections six months before the new expanded protections take effect; and (2) clarifies how to determine whether a county is considered "rural" or "underserved" for purposes of applying an exemption in the escrows rule and special provisions adopted in the other new mortgage rules.

For more information, contact Joseph Gabai at jgabai@mofo.com.

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MI Litigation: The CFPB Edition

The CFPB announced a settlement with four national mortgage insurance companies for allegedly paying kickbacks to mortgage lenders in connection with captive reinsurance arrangements, in violation of Section 8 of the Real Estate Settlement Procedures Act (RESPA). The CFPB alleged that the four defendants were paying referral fees to mortgage lenders by providing reinsurance to the lenders' captive subsidiaries at less-than-market rates. The CFPB inherited this case from HUD in July 2011 and took almost two years to complete it.

For more information, contact Michael Agoglia at magoglia@mofo.com.

MI Litigation: The NY Attorney General Edition

The New York State Department of Financial Services ("DFS") entered into consent orders with two different insurance holding companies after its investigation concluded that lenders purchased high-priced insurance policies and shared profits from policy sales with the insurers. The companies will pay $14 million and $10 million settlements, respectively, and adopt a set of standards that aim to lower force-placed insurance policy rates. The DFS Superintendent sent a letter to state insurance commissioners urging them all to adopt the same standards.

For more information, contact Michael Agoglia at magoglia@mofo.com.

National Foreclosure Review Still Under Fire

The OCC and Fed continue to face harsh criticism of the 2011 consent orders with lenders over alleged servicing errors and subsequent decision to scrap the Independent Foreclosure Reviews (IFR) required by those settlements in favor of cash settlements. In April, the Government Accountability Office (GAO) released its report on the IFR. It doles out criticism to all involved, but focuses on the complexity of the reviews, overly broad regulator guidance, and concerns about the OCC and Fed's monitoring. And the GAO isn't done yet—it recently told senators that its report is just the first part of "an ongoing review," during which it plans to assess, among other things, how regulators came up with the monetary figure to replace the IFR.

For more information, contact Michael Agoglia at magoglia@mofo.com.

HAMP Class Cert. Scorecard

The first major HAMP class cert. decision came out in April in the *Campusano* case, where a Massachusetts district court refused to certify a class of borrowers challenging the implementation of alleged permanent modification agreements. Similarly, in *Grullon* a New Jersey district court refused to certify a putative class of borrowers asserting UDAP and fraud claims for alleged improper foreclosure and "robosigning." It helpfully emphasized the individual nature of damages and the ongoing National Mortgage Settlement remediation.

Class certification briefing in the MDLs with Bank of America, Chase, and Citibank has begun. Decisions are expected this summer and into the fall. A Northern District of California judge may beat those cases to the punch in the mod class action *Gaudin v. Saxon Home Mortgage*, set for hearing in late June.

For more information, contact Michael Agoglia at magoglia@mofo.com.

TPP Circuit Split?

The First Circuit joined the Seventh Circuit in holding that the HAMP Trial Period Plan ("TPP") promises a permanent modification. *Young v. Wells Fargo Bank, N.A.*, No. 12-1405, 2013 U.S. App. LEXIS 10189 (1st Cir. May 21, 2013). The court did, though, reject claims that the lender breaches the TPP by requiring higher payments under the permanent modification agreement than those required under the TPP and affirmed the dismissal of implied covenant and emotional distress claims. The decision does not meaningfully take on the weight of authority from the Fourth, Fifth, Eighth and Eleventh Circuits holding to the contrary. Nor does it address the unique aspects of the Seventh Circuit's decision in *Wigod* that ought to distinguish it.

For more information, contact Michael Agoglia at magoglia@mofo.com.

OPERATIONS REPORT

Watch Your Exposure!

The Basel Committee on Banking Supervision published a Consultative Document that proposes a revised supervisory framework for large counterparty exposures of systemically important financial institutions. The framework would apply to all "internationally active banks" that are subject to the Basel Committee risk-based capital accord. "Large exposure" would mean 5% or more of a covered bank's "eligible capital." All covered banking organizations would be required to report all large exposures to their supervisory agencies.

The Basel Committee proposes an initial exposure limit of 25% of common equity Tier 1 capital, whereas 1991 guidance issued by the Basel Committee established a limit of 25% of total regulatory capital. To learn more, see our News Bulletin.

For more information, contact Charles Horn at chorn@mofo.com.

Are You Stressed?

The OCC issued a notice of proposed information collection seeking comment on annual stress test reporting by national banks and federal savings associations. In October 2012, the OCC issued a final rule implementing Dodd-Frank's annual stress test requirements for certain financial companies with total consolidated assets between $10 billion and $50 billion. The notice of proposed information collection now describes the reporting required by national banks and federal savings associations in connection with this testing, which the OCC intends to use to assess the reasonability of stress test results, provide forward-looking information on a covered institution's capital adequacy, and determine whether additional analytical techniques and exercises may

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be appropriate to identify, measure, and monitor risks at the covered institution.

For more information, contact Charles Horn at chorn@mofo.com.

Are You Financial?

On April 3, the Federal Reserve Board adopted a final rule that specifies when a nonbank financial company is "predominantly engaged" in financial activities for purposes of Dodd-Frank Act Title I (systemic regulation). In turn, nonbank financial firms that meet this standard would be eligible for designation by the Financial Stability Oversight Council as "systemically important" and subject to enhanced regulation under the Dodd-Frank Act. The net effect of the Federal Reserve Board's action is to expand the types of activities that might qualify as financial activities for purposes of applying the "predominantly engaged" test, and thus enlarge the population of large nonbank firms that might be designated as systemically important financial firms. To learn more, see our News Bulletin.

For more information, contact Charles Horn at chorn@mofo.com.

Are You Financial? – Part 2

Not to be outdone by the Federal Reserve Board, on June 3 the Federal Deposit Insurance Corporation adopted a final rule that specifies when a nonbank financial company is "predominantly engaged" in financial activities for purposes of Dodd-Frank Act Title II (orderly liquidation). Large nonbank financial firms that meet this standard would be eligible for resolution by the FDIC under the Dodd-Frank Act's resolution, or orderly liquidation, framework for systemically important financial institutions. The FDIC's rule closely tracks the prior Federal Reserve Board issuance, but unlike the Board's rule, includes activities that are "incidental" to a financial activity (which, at the current time, is limited to finder activities), and uses a revenue test (85% of consolidated revenues), in contrast to the Board's revenue and asset tests (85% of consolidated revenues or assets), in applying the statutory "predominantly engaged" benchmark.

For more information, contact Charles Horn at chorn@mofo.com.

Are You Important?

June 3 was a busy day for the federal regulators, who decided that if your company name is AIG, Prudential or GE Capital, then yes, you are important – systemically important, that is. The Financial Stability Oversight Council ("FSOC") voted to propose the designation of these three financial services companies as the first systemically significant nonbank financial institutions under section 113 of the Dodd-Frank Act. As a result, these three companies will become subject to the Federal Reserve Board's prudential regulatory framework for systemically important nonbank financial firms. The FSOC's action marks an important milestone in the implementation of the Dodd-Frank Act's systemic regulation framework. To learn more, see our Client Alert.

For more information, contact Charles Horn at chorn@mofo.com.

Are You Leveraged?

The Federal bank regulatory agencies released updated supervisory guidance on leveraged lending, which they report has been increasing since 2009 after declining during the financial crisis. It replaces guidance issued in April 2001. The updated guidance focuses on the following key areas: (i) establishing a sound risk-management framework; (ii) underwriting standards; (iii) valuation standards; (iv) pipeline management; (v) reporting and analytics; (vi) risk rating leveraged loans; (vii) participants; and (viii) stress testing. The guidance applies to all financial institutions supervised by the agencies that engage in leveraged lending activities, but community banks, which generally are not substantially involved in leveraged lending, should be mostly unaffected by the new guidance.

For more information, contact Charles Horn at chorn@mofo.com.

PREEMPTION REPORT

CFPB Enters the Preemption Fray

In its first preemption determination, the CFPB increased the compliance burden for gift card issuers. It addressed a Tennessee gift card law that deems gift cards abandoned after two years, triggering an obligation to transfer the unused funds to the state. The CFPB found that the five-year expiration requirement in the Electronic Funds Transfer Act and Regulation E preempted the Tennessee law to the extent that it authorized gift card issuers to refuse to honor gift cards before five years. (The decision can be found here.) This conclusion, as the CFPB recognized, creates the risk that an issuer will have to pay to a gift card holder funds that the issuer already has transferred to the state. We would have thought this is precisely the type of inconsistency that federal preemption is designed to prevent.

The CFPB also concluded that a Maine gift card law was *not* preempted, based on the Treasurer of Maine's view that the law required issuers to honor gift cards even if the issuer had transferred the funds to the state.

For more information, read our Client Alert or contact Obrea Poindexter at opoindexter@mofo.com.

Musical Hats

This quarter, a few courts have considered which types of tasks or roles played by federally chartered institutions come within the scope of federal preemption.

Mortgage Servicers: Federally chartered institutions acting as mortgage servicers are covered, according to one California appellate court, even if they did not originate the loan at issue. *Akopyan v. Wells Fargo Home Mortg., Inc.*, 215 Cal. App. 4th 120 (2013). The California court joined the Sixth and Seventh Circuits in concluding that loan servicing is an exercise of lending activities subject to preemption under the National Bank Act (NBA) and Home Owners Loan Act (HOLA).

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Trustees of Mortgage Trusts: A federal court in Massachusetts reached the opposite conclusion with respect to a national bank acting as a trustee of a mortgage trust. *Ross v. Deutsche Bank Nat'l Trust Co.*, No. 12-10586-WGY, 2013 U.S. Dist. LEXIS 47056 (D. Mass. March 27, 2013). The court relied on an OCC interpretive letter on preemption as applied to the trustees of securities trusts in deciding a trustee that did not originate, fund, or purchase the loan at issue cannot assert preemption under the NBA.

National Bank Subsidiaries: On this one, a federal court in Alabama found that preemption depends on timing. *Selman v. CitiMortgage, Inc.*, No. 12-0441-WS-B, 2013 U.S. Dist. LEXIS 37017 (S.D. Ala. Mar. 5, 2013). Dodd-Frank eliminated preemption for national bank subsidiaries as of the July 21, 2011 transfer date. In *Selman*, the plaintiffs' claims related to forced placement of insurance prior to the transfer date, and so the defendant's status as a national bank subsidiary did not impact the preemption analysis. *Id.*, at *15-16.

For more information, contact Nancy Thomas at nthomas@mofo.com.

Common Law's Covered

The Fourth Circuit recognized that common law unconscionability claims are preempted by HOLA and Office of Thrift Supervision (OTS) regulations if they seek to impose state law obligations on a federal thrift's lending activities. *McCauley v. Home Loan Inv. Bank, F.S.B.*, 710 F.3d 551 (4th Cir. 2013). The court found that the acts underlying the claim were covered by the topics expressly preempted by OTS regulations: allegations regarding a hurried closing and inflated appraisal fell "squarely within" the federal thrift's origination of the mortgage; allegations that the loan exceeded the value of the home, "[are] an attempt to regulate 'loan-to-value ratios,"; and allegations that the loan was an "exploding ARM" sought to regulate the federal thrift's terms of credit. *Id.* at 556.

For more information, contact Nancy Thomas at nthomas@mofo.com.

Fee Claim Foiled

Washington UDAP statutes are preempted to the extent that a plaintiff relies on them to challenge administrative and compliance review fees charged by a national bank on real estate loans. *Deming v. Merrill Lynch & Co.*, No. 11-35957, 2013 U.S. App. LEXIS 8910 (9th Cir. Apr. 10, 2013). Affirming the district court's dismissal, the Ninth Circuit found plaintiff's claims would obstruct the national bank's ability to exercise its federally authorized lending powers.

For more information, contact Nancy Thomas at nthomas@mofo.com.

BELTWAY REPORT

Beginning of the End?

The OCC and FDIC released their Proposed Guidance on Deposit Advance Products, small-amount short-term loans made by a bank to a deposit account holder, to be repaid from the proceeds of an upcoming direct deposit. The guidance would require banks to provide a "cooling-off" period between deposit advance loans that could last for up to 60 days and would limit consumers to six deposit advance loans per year. The guidance purports to reflect the regulators' safety and soundness concerns.

The CFPB issued a statement in support of the agencies' efforts, including its intent to prohibit unlawful, unfair, deceptive, or abusive acts and practices to limit these types of loans. Notably, the FRB did not join in the proposed guidance, instead issuing a brief policy statement reminding institutions it regulates to comply with applicable laws when offering deposit-advance products.

For more information, contact Andrew Smith at andrewsmith@mofo.com.

FDIC Flexing Its Enforcement Muscles

The FDIC has increased its enforcement efforts lately, signaling its sustained focus on capital and liquidity issues, its continued interest in consumer protection issues, its increased cooperation with state banking regulators, and its attention to Bank Secrecy Act and anti-money laundering issues. Here are a few examples:

Section 5: The FDIC and OCC settled a coordinated Section 5 deceptive practice action against Citizens Bank of Pennsylvania ("CBPA"), imposing a $5.0 million civil money penalty and approximately $1.4 million in restitution. The FDIC alleged that CBPA engaged in deceptive practices in the marketing and implementation of its overdraft payment program, checking rewards programs, and stop-payment process for preauthorized recurring electronic funds transfers.

Unsafe and Unsound Banking Practices: The FDIC went after Marine Bank & Trust Company and Columbia Bank for allegedly unsafe and unsound practices, including excessive volume of adversely classified assets, insufficient capital, lax loan administration and underwriting practices, and inadequate Allowances for Loan and Lease Losses.

Bank Secrecy Act: Consent orders between the FDIC, state agencies and the Hartford Savings Bank and Mid America Bank in Wisconsin, the Peoples Bank in Clifton, Tennessee, and Monterey County Bank in California require the banks to comply with the Bank Secrecy Act, reduce adversely classified assets to set percentages, and beef up compliance and internal controls.

For more information, contact Andrew Smith at andrewsmith@mofo.com or Nancy Thomas at nthomas@mofo.com.

More Time to Plan Your Funeral

The FRB and the FDIC announced additional guidance for the first group of 11 institutions that filed their resolution plans in accordance with Dodd-Frank requirements. Based on their review of the plans submitted in 2012, the agencies requested more detailed information on the obstacles to resolvability under the Bankruptcy Code, and on global issues, funding, and liquidity. They also extended the plan submission timeframe to October 1, 2013.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

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Tell Me More

The FRB, the FDIC, the OCC, and the Conference of State Bank Supervisors announced an increase in the number of required loan data fields in the Interagency Loan Data Request (ILDR), from 5 to 30. The ILDR is a voluntary, standardized data request that banks can use to electronically submit loan information for safety and soundness examinations. Financial institutions using the ILDR are expected to provide the new required loan data fields for examinations starting on September 30, 2013.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Leveraged Lending Guidance

Federal banking regulatory agencies released updated supervisory guidance on leveraged lending, replacing the operative April 2001 guidance. The new guidance requires financial institution policies to include criteria to define leveraged lending appropriate to the institution based on factors specified in the guidance. The agencies expect: (1) a sound risk-management framework; (2) underwriting standards that clearly define expectations in specified areas; (3) valuation standards that concentrate on the importance of sound methods and periodic revalidation of enterprise value; (4) accurate measurement of an institution's exposure; (5) management information systems that accurately capture key obligor and aggregate characteristics, with periodic reporting to the board of directors; (6) the use of realistic repayment assumptions; and (7) stress testing in accordance with existing interagency issuances.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Invest Responsibly

The federal bank regulatory agencies today requested comment on proposed revisions to Interagency Questions and Answers Regarding Community Reinvestment, focusing primarily on community development. The proposed amendments clarify how the agencies consider community development activities benefitting a broader statewide or regional area that includes an institution's assessment area; provide guidance related to Community Reinvestment Act consideration of investments in nationwide funds; and clarify how community development lending should be evaluated. Comments on the proposed revisions are due 60 days after the publication in the Federal Register.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Pay Your Dues

The FRB invited comment on a proposal to establish an annual assessment of bank and savings and loan holding companies with at least $50 billion in total consolidated assets and of nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve. The proposal reflects the authority provided in Dodd-Frank for the FRB to collect assessments, fees, or other charges equal to the expenses the FRB estimates are

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necessary and appropriate to carry out its supervisory and regulatory responsibilities for these large financial companies. The proposal specifies that 2012 would be the first assessment period, and payments would not be collected until the rule is finalized. The FRB estimates that the proposal would result in approximately 70 companies assessed for 2012 for a total of $440 million in collections. Comments on the proposal are due by June 15.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Foreign Exchange Rule

The FRB finalized its Dodd-Frank-mandated standards for FRB-regulated banking organizations that engage in certain foreign exchange transactions with retail customers. The rule establishes requirements for customer risk disclosures, recordkeeping, business conduct, and documenting retail foreign exchange transactions. Institutions engaging in such transactions have to notify the Federal Reserve, be well capitalized, and collect margin for retail foreign exchange transactions. The FRB consulted with the OCC and the FDIC in developing its rule, but the three agencies engaged in separate rulemakings as specified by Dodd-Frank. The rule became effective on May 13, 2013.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Are You "Predominantly Engaged in Financial Activities"?

The FRB issued a final rule establishing criteria for determining when a nonbank financial company is deemed to be "predominantly engaged in financial activities" in connection with the company's designation for consolidated supervision by the Fed. Under the rule, a company is considered "predominantly engaged in financial activities" if 85% or more of its revenues or assets are related to activities that are "financial in nature" under the Bank Holding Company Act. The final rule also defines the terms "significant nonbank financial company" and "significant bank holding company": a firm is "significant" if it has $50 billion or more in total consolidated assets or has been designated by the Financial Stability Oversight Council as systemically important. The final rule became effective on May 6, 2013.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

More Red Flag Rules

The Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") published rules and guidelines requiring the financial institutions they regulate to establish programs to address the risks of identity theft. The SEC's rules apply to broker-dealers, mutual funds, investment advisers, and other financial institutions and creditors. The CFTC's rules apply to futures commission merchants, retail foreign exchange dealers, commodity trading advisers, commodity pool operators, swap dealers, and major swap participants. The final rules became effective on May 20, 2013, and compliance is required by November 20, 2013. For additional information, please review our Client Alert.

For more information, contact Daniel Nathan at dnathan@mofo.com.

Floodgates of Regulation Opened

The federal banking agencies issued interagency guidance in connection with the revisions to the Flood Disaster Protection Act of 1973 ("FDPA") that were affected by the Biggert-Waters Flood Insurance Reform Act of 2012 ("Act"). Certain provisions of the Act were immediately effective, including amendments to the FDPA's forced placement provisions and the increase of the maximum civil money penalty to $2,000. Other requirements will become effective only when regulations are issued, including: the requirement that lenders accept private flood insurance policies under certain conditions, mandatory borrower disclosures about the National Flood Insurance Program, and the establishment of escrow accounts for flood insurance premiums and fees for certain loans secured by real property.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Virtual Currency, Real Regulation

The Financial Crimes Enforcement Network ("FinCEN") issued guidance clarifying how regulations implementing the Bank Secrecy Act ("BSA") apply to virtual currencies. The guidance refers to "convertible" virtual currency—currency that either has an equivalent value in real currency, or acts as a substitute for real currency. The guidance provides that virtual currency users are not a money services business ("MSB"), and therefore are not subject to MSB registration, reporting, and recordkeeping regulations. Virtual currency administrators, entities engaged in the business of issuing or putting into circulation a virtual currency, with the authority to redeem such virtual currency or withdraw it from circulation, are MSBs. The same is true for virtual currency exchangers, entities engaged in the business of the exchange of virtual currency for real currency, funds, or other virtual currency. FinCEN also clarified that providers of prepaid access are neither virtual currency administrators nor exchangers because prepaid access is limited to real currencies under FinCEN regulations.

For more information, contact Ezra Levine at elevine@mofo.com.

BSA/AML Focus Continues: Holding Companies Are Not Spared

On March 21, 2013, Citigroup Inc. and Citibank entered into consent orders with the FRB and OCC, respectively, about their BSA/AML compliance program. Banamex USA also consented to the issuance of a consent order by the FDIC and the California Department of Financial Institutions in connection with BSA/AML compliance. The FRB's consent order states that the OCC and FDIC's consent orders demonstrate that Citigroup lacked effective systems of governance and internal controls to adequately oversee the activities of the banks in connection with their BSA/AML compliance programs.

For more information, contact Barbara Mendelson at bmendelson@mofo.com.

This newsletter addresses recent financial services developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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